TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

No. 559

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

JULIAN PRICE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS

PETITION FOR CERTIORARI FILED NOVEMBER 28, 1939
CERTIORARI GRANTED JANUARY 15, 1940

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

No. 559

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

JULIAN PRICE

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

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Before United States Board of Tax Appeals

Docket No. 80540

JULIAN PRICE, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Taxpayer: Julius C. Smith, Esq., D. H. Blair, Esq., J. G. Korner, Jr., Esq., Geo. D. Brabson, Esq. For Comm'r: C. P. Reilly, Esq.

Docket entries

1935

June 18—Petition received and filed. Taxpayer notified. (Fee paid.)
June 18—Copy of petition served on General Counsel.
July 12—Answer filed by General Counsel.
July 17—Copy of answer served on taxpayer.
July 30—Revised notice, copy of answer served on taxpayer.

1937

Sept. 2—Hearing set Nov. 9, 1937.
Sept. 15—Hearing set Nov. 9, 1937, Revised notice.
Oct. 1—Motion for 60 days continuance filed by taxpayer. 10/5/37 granted, continued to 2/1/38.
Dec. 22—Application for order to take depositions of Julian Price, et al., filed by taxpayer.
Dec. 22—Notice of the appearance of Geo. D. Brabson, as counsel filed.
Dec. 23—Order to take depositions of Julian Price, et al., entered.

1938

Jan. 20—Depositions of Julian Price and Rosser L. Clark filed. Taxpayer served by notary, Commissioner by Board.
Jan. 20—Copy of deposition served on General Counsel.
Feb. 1—Hearing had before Mr. Van Fossan on merits. Submitted. On motion of petitioner and respondent, depositions in toto and exhibits received in evidence. Petitioner's brief due in 30 days. Respondent's brief in 10 days, reply in 10 days.
Feb. 8—Transcript of hearing Feb. 1, 1936, filed.
Mar. 2—Brief filed by taxpayer. 2/3/28 copy served on General Counsel.
Mar. 11—Reply brief filed by General Counsel.

1938

Apr. 12—Motion for leave to file the attached reply brief, reply brief lodged, filed by taxpayer. 4/13/38 granted.

Apr. 13—Copy of motion and reply brief served on General Counsel.

Aug. 23—Memorandum findings of fact and opinion rendered, Ernest H. Van Fossan, Div. 9. Decision will be entered under Rule 50.

Sept. 7—Computation of deficiency filed by General Counsel.

Sept. 9—Hearing set Sept. 28, 1938, on settlement.

Sept. 23—Motion for a continuance to Oct. 26, 1938, filed by taxpayer 9/24/38 granted to 11/9/38.

Nov. 9—Hearing had before Mr. Arundell on settlement under Rule 50. Respondent's recomputation not contested. Referred to Mr. Van Fossan for decision.

Nov. 10—Decision entered. C. R. Arundell, Div. 7.

1939

Feb. 6—Petition for review by United States Circuit Court of Appeals, Fourth Circuit, with assignments of error filed by taxpayer.

Feb. 6—Proof of service filed by taxpayer.

Apr. 6—Agreed praecipe for record filed, with proof of service thereon.

Apr. 7—Designation of points to be urged filed by taxpayer, with proof of service thereon.

Apr. 7—Order extending time to May 1, 1939, for transmission and delivery of record, entered.

3 Before United States Board of Tax Appeals

Petition

Filed June 18, 1935

The above-named petitioner hereby petitions for a determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:AR:C-2:GL-90D) dated April 2, 1935, and as a basis of his proceeding alleges as follows:

1. The petitioner is an individual residing at Greensboro, North Carolina.

2. The notice of deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the petitioner on April 2, 1935.

3. The taxes in controversy are income taxes for the calendar year 1932, in the amount of $28,946.03.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner erroneously disallowed a loss sustained by the petitioner in the amount of $125,000;

(b) The Commissioner erroneously added to petitioner's income $4,160.00 alleged to represent a profit realized by petitioner on the sale of 26 shares of stock of Jefferson Standard Life Insurance Company; whereas the said shares were not the property of petitioner and were sold by him merely as the nominee of another and the profit thereon was erroneously included in petitioner's income.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) In the month of September 1929, there was a merger of three banks in Greensboro, North Carolina, viz: North Carolina Bank & Trust Company, Atlantic Bank & Trust Company, and American Exchange Bank. This merger was effected in order to save the last two named banks, both of which were in a precarious financial condition. Upon an analysis being made of the assets of the Atlantic Bank & Trust Company and the American Exchange Bank, which were to be turned into the merged institution, such assets were appraised and divided into two classes which were denominated "Class A Assets" and "Class B Assets." The face value of the said "Class A Assets" was $8,723,772.74, and that of the said "Class B Assets" was $1,453,055.60. Before the newly merged institution (North Carolina Bank & Trust Company) was allowed to open for business it was required to furnish a solvent guarantee as to the value of the "Class B Assets" up to the amount of $500,000.00. The president of the Atlantic Bank & Trust Company (one of the merged banks) called upon the petitioner and two others to join him in such a guarantee.

(b) The petitioner was not a stockholder in the said bank but the financial and banking situation in Greensboro was critical and a panic seemed imminent which, if it should eventuate, would cause a financial debacle in the community and probably result in the failure of the said Atlantic Bank & Trust Company and the American Exchange Bank. Desiring to assist in averting such a debacle with its resulting losses to the community and to himself, the petitioner agreed to execute the said guaranty above referred to.

(c) Accordingly, on September 27, 1929, the petitioner, jointly with three others, executed a contract and agreement of guaranty by the terms of which they jointly and severally guaranteed the value of the said "Class B Assets" (above referred to) to the

extent of $500,000.00. The petitioner and his comakers of the said guarantee believed that the said "Class B Assets" had a value greatly in excess of $500,000 and that no liability would eventually be cast upon them by reason of their said guaranty contract.

(d) Thereupon the merged institution opened for business and listed and carried among its assets the said "Class A Assets" and "Class B Assets," and the said contract of petitioner and three others guaranteeing the said "Class B Assets" to the extent of $500,000.00. Between September 27, 1929, and September 25, 1930, the receivables, consisting of secured notes and bonds, and constituting the "Class A Assets," were reduced by collection from $8,723,772.74 to $3,155,194.57, and by August 1931, they had been further reduced by collection to $2,025,138.57; that is to say, between September 27, 1929, and August 1931, the "Class A Assets" had yielded a realization of their face value (of September 27, 1929) of $6,698,633.67. At the last mentioned date the Merger Committee valued the then remaining "Class B Assets" at $529,947.44.

(e) In June 1931, the bank called upon petitioner, and his comakers on the guaranty contract, to change the form of their guaranty so that it would be in more "bankable form," by executing their respective four notes in the amount of $125,000 each. This was done in June 1931, and the notes of the said guarantors (including petitioner) were executed and delivered in lieu of the joint and several contract of guaranty.

(f) In January 1932 there occurred a serious "run" on the merged institution, North Carolina Bank & Trust Company, which precipitated a crisis in the affairs of that bank and it was apparent that the bank would fail (it did fail later on). On April 1, 1932, the situation of the bank had grown desperate and it was ascertained that due to the depression and panic conditions obtaining in the country, the "Class B Assets" had shrunk to a point where there was no remaining value in them and that the full liability upon petitioner's guaranty was established. Thereupon demand was made upon petitioner for the payment of his note of $125,000.

(g) Petitioner did not have available the cash with which to discharge his said note but arranged with the bank to accept property in the form of high-grade securities which he then turned over to the bank, in the amount of $125,000.00.

(h) The bank was insolvent and on the verge of failure (it did fail thereafter) and investigation disclosed that there was no possibility of petitioner recovering assets out of which to recoup himself for the loss then sustained by him.

(i) Petitioner, pursuant to his written obligation of guaranty, parted with his property in the amount of $125,000.00, and thereby sustained a deductible loss in the year 1932, in the amount of $125,000.00.

(j) Petitioner took deduction for his said loss in his tax return for 1932; the Commissioner has disallowed the loss and restored $125,000.00 to taxable income of petitioner.

(k) On or about November 22, 1932, petitioner was indebted to his son, R. C. Price, for moneys which he had borrowed from him. In that year petitioner found an opportunity to buy 26 shares of the capital stock of Jefferson Standard Life Insurance Company at an advantageous price of $4,940 and accordingly purchased them at the said price for and on the account of the said R. C. Price. The certificates were issued in the name of R. C. Price and were delivered to R. C. Price by the petitioner. Shortly thereafter petitioner was called upon to raise a considerable sum of money, and, in order to raise the said funds, the petitioner sold a considerable amount of securities held by him and, in addition thereto, borrowed other and similar securities from others. Among such, the petitioner borrowed a considerable number of shares of Jefferson Standard Life Insurance Company stock from his son, R. C. Price, and among such borrowed shares were the said 26 shares of Jefferson Standard Life Insurance Company stock, which were referred to above. Petitioner thereupon
8 sold the securities which he had borrowed from his son and others, along with those owned by himself, in order to raise the funds above referred to. Among such securities sold by petitioner, as aforesaid, were the shares borrowed from R. C. Price, among which were the said 26 shares of Jefferson Standard Life Insurance Company stock. In order to transfer a proper title the petitioner caused the said 26 shares to be transferred into his name. Petitioner sold all of the said shares, including the said 26 shares. On all of such stock sold at an advance in price, the profit was duly reported by the owner thereof, i. e., the lender of the stock to petitioner. Likewise, R. C. Price reported in his tax return as his profit the gain realized on the sale by petitioner of the stock borrowed from him (R. C. Price). The small block consisting of the said 26 shares were sold for $9,100.00 and the gain thereon was $4,160, which R. C. Price reported as his taxable profit. The Commissioner has added to petitioner's income the said amount of $4,160, alleging the said amount to represent a profit to the petitioner. This the petitioner denies.

Wherefore, the petitioner prays the Board to hear this proceeding and to decide and order (1) that petitioner sustained a deductible loss of $125,000.00 in the year 1932, and (2) that the

profit of $4,160.00 on the sale of 26 shares of Jefferson Standard Life Insurance Company stock was not the profit of
9 petitioner and did not constitute taxable income to the petitioner.

(S) JULIUS C. SMITH,
Julius C. Smith,
(S) D. H. BLAIR,
D. H. Blair,
(S) J. G. KORNER, Jr.,
J. G. Korner, Jr.
Transportation Bldg., Washington, D. C.,
Attorneys for petitioner.

[*Duly sworn to by Julian Price; jurat omitted in printing.*]

10 *Exhibit A to Petition*

SN–A.

IT:AR:C–2.
GL–90D.

APR. 2, 1935.

Mr. JULIAN PRICE, *Greensboro, North Carolina.*

SIR: You are advised that the determination of your income tax liability for the year(s) 1932, discloses a deficiency of $28,946.03, as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1932, as amended by section 501 of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P–7. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.
By (Signed) CHAS. T. RUSSELL,
Deputy Commissioner.

Enclosures:
Statement.
Form 870.
GL/EW–1.

11 STATEMENT

IT:AR:C-2.
GL-90D.

In re: Mr. Julian Price, Greensboro, North Carolina

Income Tax Liability

Year, 1932: Income Tax Liability, $30,365.67; Income Tax Assessed, $1,419.64; Deficiency, $28,946.03.

The deficiency shown herein is based upon the reports dated February 6, 1934, and May 2, 1934, prepared by Revenue Agent C. F. Strandberg and transmitted to you under dates of February 20, 1934, and May 9, 1934. In Bureau letter dated September 27, 1934, you were advised that the agent's reports referred to above had been approved by this office. Your protest relative thereto has been carefully considered in connection with the information presented at a conference in this office with your representative October 24, 1934.

Net income reported in return	$23,220.47
Add:	
1. Interest paid	3,750.00
2. Losses	125,000.00
3. Profit on sales	23,225.00
Net income adjusted	$175,195.47

Explanation of Changes

1. Interest deduction has been reduced from $31,958.24 to $28,208.24 due to the elimination of two items of $1,875.00 which were not actually paid in cash in the year 1932.

2. The deduction claimed by you which has been disallowed represents your share of the guarantee, in the merger of the Atlantic Bank and Trust Co. with the North Carolina Bank and Trust Co. that class A assets taken over by the new bank should be made good.

The guaranty contract was executed by you and three other individuals, each one being jointly and severally liable to the extent of $500,000.00.

The North Carolina Bank and Trust Co. took over the class A assets of the old bank in 1929, the class B assets being pledged to make the class A assets good. In the year 1931 it became apparent that the class B assets were not sufficient to cover the losses and the guarantors were each called upon to make the payments under their contract.

12 You as one of the guarantors executed in the year 1931 a note for $125,000.00, and also endorsed the note of another guarantor, Mr. C. W. Gold, in the amount of $125,000.00. Mr. Gold's note was secured by a $50,000.00 life insurance policy which, as it later developed, was allowed to lapse, and stock of the Jefferson Standard Life Insurance Co. standing in the name of your wife. As collateral for your own note you also borrowed from your wife.

In April 1932 you gave your note for $50,000.00 covering your original $125,000.00 note and the $125,000.00 note of Mr. Gold. This was fully secured by collateral. At the maturity of the note in 1933 the bank accepted in payment bonds of an equal amount of the Southwestern Realty Co. and the bank endorsed the note over to your wife and daughter.

In your 1932 return you claimed as a deduction $125,000.00 representing your pro rata share of the guaranty, which you considered a loss at that time. This is not the year in which the note was paid.

You contend that you did not claim the deduction in the year 1931 for the reason that you did not believe that a loss on the note would eventually be sustained; that in 1932 you first placed property of your own with the bank as collateral, at which time you substituted securities of your own for those borrowed from members of your family, and that as a result the note when finally paid in 1933 was endorsed over to the members of your family from whom you had previously borrowed the securities; which under the circumstances was equivalent to paying the debt in 1932 when you first put up collateral of your own. On the basis of the evidence the loss should be allowed either in the year 1931 when you first gave your note and when the other guarantor who was able to pay, paid his note in cash or in the year 1933 when the indebtedness was settled and the note surrendered.

Your income is reported on the cash receipts and disbursements basis, and under several decisions of the courts and the United States Board of Tax Appeals a taxpayer on the cash receipts basis who is an endorser or guarantor of notes of another when called upon to make good his endorsement by giving his personal note therefor does not suffer a deductible loss until the obligation is finally paid. (Eckert v. Burnet, 383 U. S. 140, James K. Bowen, 27 Board of Tax Appeals Reports, page 824; and Edward A. Hughes, 27 Board of Tax Appeals Reports, page 1022).

It is held by this office that under the provisions of section 23 (j) of the Revenue Act of 1932 the loss is not one sustained in the year 1932.

3. The profit on sale of stock in the Jefferson Standard Life Insurance Co. has been increased from $129,240.00 to $152,465.00, determined as follows:

Computation of Cost of 800 Shares of Jefferson Standard Life Insurance Co. Sold in 1932

C. Stock Held More Than Two Years

Acquired from	Date acquired	Shares sold	Sale price	Cost	Profit
C. C. Taylor	11-15-19	100		$15,000.00	
Julian Price, Trustee	2-11-13	100		6,750.00	
Julian Price, Trustee	2-11-13	100		6,750.00	
C. C. Taylor	11-15-19	100		15,000.00	
I. H. Gantt	3-22-26	5		1,500.00	
T. C. Smith	3-22-26	20		6,500.00	
P. B. Falls	8-25-26	1		400.00	
A. G. Meyers	8-25-26	3		1,200.00	
Atlantic Bank, Trustee	8-25-26	1		100.00	
Total		430	$150,500.00	$53,000.00	$97,500.00

Stock Held Less Than Two Years

G. A. and Mrs. Holderness	10-20-32	100		$21,000.00	
R. C. Price	12-5-32	50		17,500.00	
B. C. Mayo	12-5-32	50		17,500.00	
R. C. Price	12-5-32	20		7,000.00	
R. C. Lucas	8-2-32	10		1,170.00	
J. E. Vochringer, Jr.	8-2-32	15		2,265.00	
R. C. Price	12-5-32	80		14,240.00	
Mrs. C. W. Gold	10-20-32	97		9,120.00	
G. A. Holderness	10-20-32	3		600.00	
S. Hallhonor	12-5-32	1		530.00	
Albert Anderson	12-5-32	1		800.00	
Totals		350	$129,500.00	$74,535.00	$54,965.00
Total					$152,465.00

It will be noted that $97,500.00 of the profit is considered capital net gain and $54,965.00 ordinary gain.

You have protested the inclusion of $4,100.00 profit on sale of 26 shares which were acquired December 5, 1932, from your son, R. C. Price, on the grounds that the sale was one made by your son.

The records, however, of the North Carolina Bank and Trust Co. show that a check was issued by you November 22, 1932, in the amount of $4,940.00, and that the proceeds of the sale were received by you. There is no indication that the profit on the sale was turned over to your son. The profit on the sale is one held to have been realized by you.

14 **Computation of Tax**

Net income		$175,195.47
Less: Capital net gain		97,500.00
Net income subject to surtax		$77,695.47
Less:		
Dividends	$8,248.00	
Personal exemption	4,100.00	
		12,348.00
Balance subject to normal tax		$65,347.47
Normal tax at 4% on $4,000.00		160.00
Normal tax at 8% on $61,347.47		4,907.80
Surtax on $77,695.47		13,110.27
Capital net gain at 12½% on $97,500.00		12,187.50
Total tax assessable		$30,365.67
Previous assessment		1,419.64
Deficiency		$28,946.03

15 **Before United States Board of Tax Appeals**

[Title omitted.]

[File endorsement omitted.]

Answer

Filed July 12, 1935

The Commissioner of Internal Revenue, by his attorney, Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1. Admits the allegations of paragraph 1.

2. Admits the allegations of paragraph 2.

3. Admits the taxes in controversy are income taxes for the calendar year 1932, but denies that the amount is $28,946.03.

4. (a) Denies the error complained of in paragraph 4 (a).

(b) Denies the error complained of in paragraph 4 (b).

5. (a) Admits the matter set forth in the first, second, third, fifth, and sixth sentences of paragraph 5 (a), and denies the remainder thereof.

(b) Admits the petitioner agreed to execute the said guaranty above referred to, and denies the remainder of paragraph 5 (b).

(c) Admits that accordingly, on September 27, 1929, the petitioner, jointly with three others, executed a contract and agreement of guaranty, and denies the remainder of paragraph 5 (c).

(d) Admits that thereupon the merged institution opened for business and listed and carried among its assets the

16 said "Class A Assets" and "Class B Assets," and the said

contract of petitioner and three others, and denies the remainder of paragraph 5 (d).

5. (e) Admits that in 1931, the petitioner, and his co-makers, on the guaranty contract, executed their respective four notes in the amount of $125,000 each, and denies the remainder of paragraph 5 (e).

(f) Denies the matter set forth in paragraph 5 (f).

(g) Denies the matter set forth in paragraph 5 (g).

(h) Denies the matter set forth in paragraph 5 (h).

(i) Denies the matter set forth in paragraph 5 (i).

(j) Admits that petitioner took deduction for an alleged loss of $125,000.00 in his tax return for 1932; that the Commissioner disallowed it and restored $125,000.00 to taxable income of petitioner, and denies the remainder of paragraph 5 (j).

(k) Admits that during the year 1932, petitioner sold a considerable amount of securities held by him, and denies the remainder of paragraph 5 (k).

Denies, generally and specifically, each and every allegation in the taxpayer's petition contained not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the taxpayer's appeal be denied.

(Signed) ROBERT H. JACKSON,
Assistant General Counsel
for the Bureau of Internal Revenue.

Of Counsel:
J. E. MARSHALL,
PAUL E. WARING,
Special Attorneys,
Bureau of Internal Revenue.

JEM/cal 7/11/35.

17 Before United States Board of Tax Appeals

JULIAN PRICE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 80540

Where petitioner, in order to put his obligation as a guarantor in more bankable form, gave a bank his personal note, which note he subsequently "paid" by the giving of another note for the amount of his original note and the note of another, Held, petitioner may not deduct as a loss the amount of his original

note, no actual payment for the new note having been made in the taxable year.

David H. Blair, Esq., and George D. Brabson, Esq., for the petitioner.

Charles P. Reilly, Esq., for the respondent.

Memorandum findings of fact and opinion

Aug. 23, 1938

This proceeding was brought for a redetermination of a deficiency of $28,946.03 in petitioner's income tax for the calendar year 1932.

Two questions are presented by the case. The first concerns the deductibility as a loss under section 23 (e) of the Revenue Act of 1932, of an alleged payment whereby petitioner satisfied his obligations as guarantor by giving a bank his personal note in the amount of the obligation and at the same time receiving from the bank his personal note theretofore given the bank in order that the guaranty might be "in more bankable form."

The second question is whether petitioner's income for the taxable year should be increased by an amount of profit arising out of the sale of certain stock which, upon a prior purchase by petitioner, had been given to and placed in the name of petitioner's son.

18 *Findings of fact*

The petitioner is a resident of Greensboro, North Carolina, and filed a joint return with his wife for the taxable year in question. This return was filed on a cash receipts and disbursements basis.

During the year 1929 petitioner was a stockholder of the Atlantic Bank and Trust Company of Greensboro (hereinafter called Atlantic Bank). Petitioner at that time was also president and a substantial stockholder of the Jefferson Standard Life Insurance Company of Greensboro (hereinafter called Jefferson Standard Life), which company owned 1,543 shares of stock and was a large depositor in the Atlantic Bank. As a stockholder and officer of the Jefferson Standard Life petitioner was vitally interested in its investment and deposit in the Atlantic Bank.

During the month of September 1929 the Atlantic Bank was a party to a plan for the merger of a number of banks and trust companies in the Greensboro territory. The directors of the several banks and trust companies had agreed upon a plan of

merger, and a committee had been formed to pass upon the assets tendered by the several merging banks. After making an appraisal of the assets of the Atlantic Bank the merger committee decided that it could not accept the Atlantic Bank assets as sufficient to cover the obligations of that bank to be assumed by the North Carolina Bank and Trust Company, which was to be the name of the newly formed bank (hereinafter called North Carolina Bank), unless some guaranty of those assets was given. Realizing that it would be quite detrimental to the Atlantic Bank to be eliminated from the merger after the
19 plan of merger had already been made public the four principal stockholders of the Atlantic Bank agreed to and did execute the required guaranty. The four stockholders executing this guaranty were Julius W. Cone, Charles W. Gold, J. S. Duncan, and petitioner.

For the purposes of the merger and guaranty agreement the assets of the Atlantic Bank were divided into two classes, designated "conditionally accepted," or "A" assets, and "pledged assets" or "B" assets. Pursuant to the guaranty agreement the "B" assets were delivered to the newly formed North Carolina Bank, in trust, with authority to charge any losses which might be established in the "A" assets, within a specified time, against the account of the "B" assets. The guaranty was fixed under the merger agreement at two years from September 28, 1929, but was subsequently extended by consent of the guarantors to September 28, 1932.

The above-mentioned guaranty was dated September 27, 1929, and provided in substance that if the North Carolina Bank failed to realize a certain sum from the "A" assets within two years from September 28, 1929, the four guarantors jointly and severally would make up the deficiency so ascertained in an amount not exceeding $500,000; that the "B" assets were to be used to apply first to any losses occurring in the "A" assets, and any balance then remaining in the "B" assets was to be used to reimburse the four guarantors for any sums that may have been paid under the guaranty.

The North Carolina Bank commenced business with the assets of the several merged banks and continued to operate as a general banking institution for several years. The bank ad-
20 ministered the above-mentioned "B" assets in accordance with the provisions of the merger and guaranty agreement.

In June 1931 the president of the North Carolina Bank advised the guarantors that the "B" assets were not in such shape that the bank could use them to the extent necessary for bankable purposes and, therefore, the bank requested the guarantors to put

their guaranty into bankable form so that it could be used to obtain bank credit. In compliance with this request petitioner executed and delivered to the bank his note for $125,000 and endorsed a similar note of C. W. Gold for the same amount. In consideration for the execution of these notes on the part of petitioner the bank agreed that the liability of petitioner under the guaranty should not be in excess of $250,000.

Security was placed with the bank for petitioner's note by the deposit as collateral of 4,000 shares of Pilot Life Insurance Company stock standing in the name of petitioner's wife. On November 14, 1931, these 4,000 shares were exchanged for 400 shares of Jefferson Standard Life stock belonging to petitioner's wife. There was also deposited as collateral a life-insurance policy on petitioner's life in the face amount of $100,000, payable to petitioner's wife as beneficiary.

Collateral for the Gold note was 400 shares of Jefferson Standard Life stock standing in the name of petitioner's wife and an insurance policy in the face amount of $50,000 on the life of Gold.

On December 23, 1931, 200 shares of the Jefferson Standard Life stock which had been deposited as collateral on the Price note were released and in lieu thereof there was deposited as collateral 50 shares of Jefferson Standard Life stock belonging to petitioner's wife and 500 shares of Greensboro News Company's preferred stock belonging to petitioner's daughter.

Thus on December 23, 1931, there was the following collateral for both notes: 650 shares of Jefferson Standard Life stock belonging to petitioner's wife, 500 shares of Greensboro News Company stock belonging to petitioner's daughter, and the above-mentioned insurance policies.

All of this security was still held by the bank on March 28, 1932, the time of the transaction here in issue, and was retained as collateral for petitioner's note of that date for $250,000.

In August 1931 the North Carolina Bank had an appraisal made as of that date of all its assets, including the "B" assets held by it as trustee. This appraisal was made on the basis of the fair market value of the assets at that time and showed a total value remaining in the "B" assets of $529,947.44.

At the end of 1931 the guaranty agreement was still in force and effect. The "B" assets were still in the hands of the North Carolina Bank, as trustee, and were still in the process of collection. No demand had ever been made upon petitioner for the payment of any part of his obligation under the guaranty. While it was known that there would be some loss to the guarantors it was not definitely known throughout 1931 what the

amount of the loss would be, and the guarantors had every reason to believe there would be a substantial reimbursement from the "B" assets of any losses.

It was on September 28, 1931, that the guarantors signed the above-mentioned extension of time for the final liquidation of the "B" assets to September 28, 1932.

22 Late in December 1931 a run was made on the United Bank and Trust Company of Greensboro, the only other commercial bank then in operation in the city, causing it to close its doors and fail on the same day the run occurred.

The failure of the United Bank and Trust Company precipitated a similar run on the North Carolina Bank on the same day. After the first active run on the North Carolina Bank was over, withdrawals continued throughout the best part of January 1932, and the deposits withdrawn never came back. By borrowing approximately $8,000,000 from the Reconstruction Finance Corporation the bank was able to stay open.

The closing of the United Bank and Trust Company and the run on the North Carolina Bank brought about a marked change in the value of all the bank's assets, and especially the "B" assets.

Conditions in Greensboro and the condition of the bank's assets had grown worse throughout the first part of 1932, and collections had diminished on both "A" and "B" assets to such an extent that there was no possibility of recovering anything from the "B" assets.

In the latter part of March 1932 petitioner, in his discussions with officials of the North Carolina Bank, was informed that the bank had decided that the possibilities of collecting anything on the "B" assets were remote and that there was no hope of any relief from these assets. The bank requested that petitioner make a final settlement of his obligation under the two notes and the guaranty to the bank. Petitioner proposed to pay the two notes (his own note and Gold's note on which he was endorser) by giving the bank his note for $250,000. The bank accepted,

23 and the C. W. Gold note in the amount of $125,000, endorsed by petitioner, and petitioner's individual note in the same amount were paid by the note of petitioner in the amount of $250,000, dated March 28, 1932.

Upon the delivery of this note for $250,000, the bank marked "paid" and turned over to petitioner the two notes which had been executed under the guaranty agreement. Both petitioner and the bank considered this to be a final payment of the two notes given under the guaranty. Petitioner deducted as a loss on his 1932 return the sum of $125,000, the amount of his own note theretofore held by the bank.

C. W. Gold died the latter part of 1932, and it was necessary for petitioner to look to Gold's estate for reimbursement of the $125,000 paid on account of his note. The estate, under the laws of North Carolina, had one year within which to collect the assets and settle the estate. The $50,000 insurance policy on Gold's life, which had been deposited as collateral, had been allowed to lapse. In 1933 it became apparent that petitioner could expect no reimbursement or recoupment from the Gold Estate, and the loss thereon was claimed and allowed for that year.

The bank retained the same security for the $250,000 note as it previously held under the two guaranty notes. In December 1932 petitioner requested the bank to allow him to substitute certain securities of his own for those of his wife and daughter. This request was granted, and in that month petitioner substituted 600 shares of Jefferson Standard Life stock of his own in lieu of 600 shares of stock of the same company belonging to his wife.

24 Early in 1933 petitioner purchased for his wife's account $100,000 par value North Carolina B. & T. Buildings, Inc., bonds. Shortly thereafter petitioner's daughter, Kathleen Price Bryan, acquired $150,000 additional bonds of the same company by exchange for $150,000 par value shares of stock in Greensboro News Company, with the Pilot Insurance Company. On November 18, 1933, petitioner's $250,000 note, together with all securities attached, was transferred and assigned by the bank's conservator, without recourse, to petitioner's wife and daughter in consideration of the transfer to the conservator of the $250,000 bonds of North Carolina B. & T. Buildings, Inc., which bonds had been acquired as aforesaid. Petitioner's note and the securities attached are now held by his son-in-law, Mr. Bryan, as agent or trustee for Mrs. Price and Mrs. Bryan.

In 1930 petitioner borrowed $150,000 from his son, Ralph C. Price, and on or about November 22, 1932, was still heavily indebted to him.

Petitioner had an opportunity, on or about this last mentioned date, to purchase 26 shares of Jefferson Standard Life stock at $4,940, which was an advantageous price. This stock was purchased by petitioner with his own money. It was transferred to petitioner's son's name and was delivered to and held by the son.

About the time of the above-mentioned purchase petitioner was negotiating to sell 1,000 shares of Jefferson Standard Life stock. This sale was consummated early in December of the taxable year. Included in the 1,000 shares sold were the 26 shares above-mentioned which petitioner had had transferred to himself so that he could effect the sale. The sale price for

25 the 26 shares in question was $9,100, or a gain of $4,160. After the sale petitioner gave his son no money but states that he will give him credit for the gain when the final settlement is made of petitioner's indebtedness to his son. It had not been made by January 1938. Petitioner's son, and not petitioner, reported the $4,160 on his 1932 Federal income tax return as gain.

Opinion

VAN FOSSAN: We first address ourselves to the question of the deductibility of the alleged payment in March 1932 in settlement of petitioner's liability under the guaranty agreement.

Respondent bottoms his entire argument on this issue on Eckert v. Burnet, 283 U. S. 140, and Frank Kuhn, 34 B. T. A. 274, together with the facts that petitioner was on a cash receipts and disbursements basis and paid the bank no cash in the taxable year in question.

The Eckert case is authority for the rule that a taxpayer on the cash basis may not, until he pays the note, deduct, either as a sustained loss or as a bad debt, the amount of a note made by him as primary obligor in substitution for a note given by another upon which the taxpayer had theretofore been a secondary obligor.

In Frank Kuhn, supra, the taxpayer, recognizing the rule of the Eckert case, sought to distinguish it on the basis that he had made a pledge of property to collaterally secure the new note. This argument was rejected, it being said that it

"* * * treats the pledge as if it were a loss of the property. This clearly is not correct. Title to the property continues in the pledgor, and by paying the debt he may retake possession. * * * Thus the loss is no more realized in this case because the taxpayer has deposited collateral than in the Eckert case, where collateral was not mentioned."

26 Petitioner in the present case, conceding the rule of the Eckert case, seeks to show that the rule is not applicable with reference to his personal liability on the guaranty upon the facts.

His theory of the case, in substance, is that his liability under the guaranty agreement and the note given to put the guaranty in more bankable form, was a contingent liability and did not become fixed and determined until March 1932, when the bank informed him that the "B" assets were not going to be sufficient to meet the failures or deficiencies in the "A" assets and that it was not until then that he agreed to pay this liability by giving the bank his note for $250,000, collaterally secured, and the bank agreed to accept this note as payment. On this premise he argues

that he was not giving one note in lieu of another, but was paying a new obligation that was not fixed until that time.

Petitioner seeks to prove his case by citation of authorities to the effect that payment is whatever the parties to the transaction consider payment. As an abstract rule of law this might be conceded; but it misses the gist of the conception of "payment" under the income tax laws when the taxpayer is on the cash basis. Payment for this purpose contemplates an outlay of cash, or its equivalent, and not a mere shifting of the nature of the liability. In such a situation a loss may become fixed and determined at a particular time, but it is not sustained until paid. The payment contemplated is an actual payment of cash. As was said in Hart v. Commissioner, 54 Fed. (2d) 848, and quoted in Jacob F. Schoellkopf, Jr., 35 B. T. A. 855:

27 "It is inconsistent with the cash receipts and disbursements method of accounting that the petitioner be permitted to claim a deduction where there has been no actual payment of cash. This basis of accounting requires that he report only actual receipts and deduct only actual disbursements."

A. W. D. Weis, 13 B. T. A. 1284, is relied on by petitioner. However, as was said in Frank Kuhn, supra, the distinction between the Weis case and Eckert v. Burnet, supra, "appears in Burn Manufacturing Co. v. Commissioner, 59 Fed. (2d) 504, in which it is also said that the Weis case must be regarded as overruled by the Eckert case, in so far as it considers the cash basis." See Max Gross, 36 B. T. A. 759.

Petitioner calls attention to certain language in John C. Hermann, 27 B. T. A. 409, which he urges is still a fair statement of the law notwithstanding S. E. Thomason, 33 B. T. A. 576. This language is, in line with the principle enunciated many times,[1] that an obligation of a taxpayer on the cash basis may be deducted when paid with borrowed funds for which taxpayer has given his note and posted collateral. That, however, is not the present situation.

In our opinion petitioner's case is clearly within the rule as laid down by the Supreme Court in the Eckert case and followed or recognized in subsequent cases.[2] Although petitioner's

28 liability prior to March 1932 arose out of the guaranty agreement and the note was given to put that guaranty

[1] Crain v. Com'r, 75 Fed. (2d) 962; Menihan v. Com'r, 79 Fed. (2d) 304; and Humphrey v. Comm., 91 Fed. (2d) 155; Robert B. Keenan, 20 B. T. A. 498.

[2] Page v. Rhode Island Hospital Trust Co., 80 F. (2d) 192, aff'g Rhode Island Hospital Trust Co. v. Page, 14 F. Supp. 481; Menihan v. Com'r, 79 F. (2d) 305; Crain v. Com'r, 75 F. (2d) 962; Max Gross, 36 B. T. A. 759; Jacob F. Schoellkopf, Jr., 35 B. T. A. 855; Edmund A. Hughes, et al., 27 B. T. A. 1022; E. C. Pratt, 23 B. T. A. 148; Herman Axelrod, 18 B. T. A. 927; T. Harvey Ferris, 38 B. T. A. — (Aug. 11, 1938); cf. Ben Greenbaum, 20 B. T. A. 469.

into bankable form, it cannot be said that petitioner had no liability on the agreement and on the note. If this were true the execution of the agreement, the giving of the note, and the depositing of collateral therefor would have been empty gestures. Petitioner's personal liability was contingent, but in our opinion is comparable to the liability of an endorser, which was the situation in Eckert v. Burnet, supra. For present purposes there is no distinction. Petitioner has satisfied his liability as guarantor under the guaranty agreement and note by a shifting of the form of his liability. His liability under the guaranty agreement and note could have been met by a sale or forfeit of the collateral, but rather than have this take place petitioner elected to give a new note promising to pay in the future.

Whether or not petitioner suffered an economic diminution of his estate may be grounds for abstract argument, but it is clear that he made no outlay of cash in the purported payment. As we have before stated, this is the real guide for determining whether petitioner suffered a loss in the taxable year in question. Petitioner's loss is deductible in the year in which he pays the note.

We believe that the second question of this case, concerning the taxability of a profit on the sale of certain stocks, must be decided in favor of petitioner, who claims that in the sale of the stocks in question he was acting on behalf of his son. Even after subjecting this entire transaction to the close scrutiny prescribed for intra-family dealings (John E. Zimmerman, 29 36 B. T. A. 279; Nathan R. Adlen, 38 B. T. A. — (July 22, 1938)), no lack of bona fides is evident.

Petitioner had a business reason for having the stock, upon its purchase by him, transferred in his son's name and physically delivering the stock to his son. He was liquidating in part a long-standing indebtedness to his son. When the stock was thereafter transferred to petitioner's name and delivered to him it was for the purpose of facilitating the sale of the large block of the same stock being sold by petitioner. The 26 shares of stock being sold were none the less the property of petitioner's son. The further fact that petitioner's son reported the gain thereon in his 1932 Federal income-tax return is persuasive of the status of the stock's ownership.

For respondent to prevail on this issue it would be necessary to discredit completely petitioner's testimony. We can find no justification in the record for such action.

Decision will be entered under rule 50.

Entered August 23, 1938.

Enter:

30 Before United States Board of Tax Appeals

Docket No. 80540

JULIAN PRICE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Decision

Pursuant to memorandum opinion entered August 23, 1938, the respondent in the above entitled proceeding filed a proposed computation with the Board on September 7, 1938, and the case having been called for settlement on November 9, 1938, at which time no objection was offered to the respondent's proposed computation, it is

Ordered and decided: That there is a deficiency in income tax for the year 1932 in the amount of $27,144.92.

(Signed) C. R. ARUNDELL,
Member.

Enter:
Entered Nov. 10, 1938.

31 In United States Circuit Court of Appeals for the Fourth Circuit

United States Board of Tax Appeals, Docket No. 80540

JULIAN PRICE, PETITIONER ON REVIEW

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, RESPONDENT ON REVIEW

Petition for review and assignments of error

Filed Feb. 6, 1939

To the Honorable Judges of the United States Circuit Court of Appeals for the Fourth Circuit:

Now comes Julian Price in support of this, his petition for review, filed pursuant to the provisions of section 1001 of the Revenue Act of 1926, as amended by section 1001 of the Revenue Act of 1932, for review of the decision of the United States Board of Tax Appeals entered November 10, 1938, determining

and ordering a deficiency in income tax against this petitioner for the calendar year 1932, in the amount of $27,144.92, and respectfully shows:

I

Your petitioner on review hereinafter referred to as the taxpayer is an individual residing at Greensboro, North Carolina, and filed his income-tax return for the year 1932 with the Collector of Internal Revenue for the District of North Carolina, whose office is located in the city of Raleigh, North Carolina.

Your respondent on review hereinafter referred to as the Commissioner is the duly appointed, qualified, and acting Commissioner of Internal Revenue of the United States.

32 II

The Commissioner determined a deficiency in Federal income taxes against the taxpayer for the calendar year 1932 in the amount of $28,946.03, and on April 2, 1935, in accordance with the provisions of section 272 of the Revenue Act of 1932, sent to the taxpayer by registered mail a notice of said deficiency. Thereafter, on June 18, 1935, the taxpayer filed his appeal from said notice of deficiency to the United States Board of Tax Appeals, being docket No. 80540.

On August 23, 1938, the Board of Tax Appeals promulgated its memorandum opinion and on November 10, 1938, entered its final order and decision in said cause, wherein and whereby the Board decided that the deficiency determined by the Commissioner was correct, except for one minor issue which the Board decided for the taxpayer, and that there was a deficiency against the taxpayer for the year 1932 in the amount of $27,144.92.

The opinion of the Board of Tax Appeals is not reported.

III

The nature of the controversy is as follows:

Taxpayer is an individual, married and living with his wife in Greensboro, North Carolina. He and his wife filed a joint return for the year in question.

During the year 1929 taxpayer was a stockholder and director in the Atlantic Bank & Trust Co. of Greensboro, N. C. Taxpayer was also president of, as well as a large stockholder in, the Jefferson Standard Life Insurance Co. of Greensboro, which company owned 1,543 shares of the capital stock of the same bank; hence the taxpayer was vitally interested both personally
33 and as an officer in the welfare of the Atlantic Bank & Trust Co.

During September 1929 a plan was in progress for the merger of a number of banks in Greensboro and the surrounding cities. The directors of several banks had agreed upon a plan of merger, and a merger committee was formed to pass upon and accept or reject the assets tendered by the several banks, including the Atlantic Bank & Trust Co. Taxpayer, as a director of Atlantic Bank & Trust Co., attended several meetings of this merger committee. That committee made an appraisal of the assets of the several banks to determine what assets should be taken over by the new bank.

The merger committee finally decided that it would not accept the assets of Atlantic Bank & Trust Co. as sufficient to cover the obligations of that bank to be assumed by the new bank, known as North Carolina Bank & Trust Co., unless some guaranty of those assets was given. To prevent the Atlantic Bank & Trust Co. from being eliminated from the merger, taxpayer and three other stockholders of that bank, to wit, Julius W. Cone, C. W. Gold, and J. S. Duncan, agreed to and did execute the required guaranty in the amount of $500,000.

Accordingly, the assets of Atlantic Bank & Trust Co. were divided into two classes, designated "conditionally accepted" or Class A assets, and "pledged assets" or Class B assets. Under this guaranty agreement the Class B or pledged assets were delivered to the North Carolina Bank & Trust Co. in trust, to collect, and, if it became necessary, to charge any losses which might be established in the Class A assets within a two-year period, against the pledged or Class B assets. This guaranty period was subsequently extended by consent of the guarantors
34 to September 28, 1933.

The guaranty provided, in brief, that the North Carolina Bank & Trust Co. should proceed to administer and to collect both classes of assets; that if the Bank failed to realize a fixed amount from the Class A assets within two years from September 28, 1929, the four guarantors would jointly and severally make up any deficiency so ascertained, in an amount not exceeding $500,000, with the further provision, however, that the Class B assets should be used to apply first to any losses occurring in the Class A assets, and second to reimburse the guarantors for any liabilities incurred under the guaranty.

The North Carolina Bank & Trust Co. commenced business with the assets of the several merged banks, and operated as a banking institution for several years. It administered the Class B assets in accordance with the provisions of the guaranty agreement.

In June 1931 the North Carolina Bank & Trust Co. advised the four guarantors that the Class B assets were not in such

shape that the bank could use them to the best advantage for banking purposes, and accordingly requested the guarantors to put their guaranty in more bankable form in order that it could be used to obtain bank credit. Accordingly, the guarantors agreed to execute and deliver to the bank their several notes for $125,000 each. Taxpayer also agreed to endorse C. W. Gold's note, and in consideration the bank agreed that petitioner's liability under the guaranty should not exceed the $250,000 evidenced by these two notes. Taxpayer also agreed that as a further security under his guaranty he would put up certain shares of stock to secure the payment of the two notes.

35 In August 1931, the North Carolina Bank & Trust Co. had an appraisal made of all its assets, including the Class B assets which it held as trustee. This appraisal showed a fair market value of the Class B assets amounting to $529,947.44 as of August 31, 1931.

On September 28, 1931, the guarantors signed an agreement consenting to the extension of the time for collection of the Class B assets to September 28, 1932.

Up to the end of 1931 the guaranty agreement was still in full force and effect. The Class B assets were still held by the Bank and were in process of collection. No demand had ever been made upon any of the guarantors for payment of any part of their obligations under the guaranty. While it was known that there would be some liability on the part of the guarantors, it was not definitely known how much the loss would be and the guarantors had every reason to believe that there would be a substantial recovery and reimbursement from the Class B assets of any losses occurring under the guaranty.

Late in December 1931, however, a disastrous run occurred on the banks in Greensboro, closing all the other commercial banks except the North Carolina Bank & Trust Co. The failure of the other banks which followed precipitated similar runs on the North Carolina Bank & Trust Co. These runs continued throughout January 1932, and quiet withdrawals continued thereafter. After these bank failures and runs had continued for some months, financial and business conditions in Greensboro and the surrounding territory became distressing, and were so

36 demoralized that the people were in desperate straits for credit or funds. Securities dropped precipitously in value. These circumstances brought about a changed condition in the value of banking assets which seriously affected the whole financial structure and eventually caused the Bank to fail. The Class B assets were badly affected as they were the lowest down in the scale.

Conditions grew worse throughout the early part of 1932, and during the first few months of that year collections on both Class A and Class B assets decreased to such a point that it became evident there was no possibility of realizing anything from the Class B assets. Taxpayer, as a member of the Executive Committee of the North Carolina Bank & Trust Co. discussed these conditions with officials of the Bank, as well as the matter of his guaranty.

In the latter part of March 1932, taxpayer was finally informed by the Bank officials that the possibility of collecting anything on the Class B assets had decreased to such a point that there was no longer any hope of relief from that source. The Bank, therefore, requested taxpayer to make a final settlement of his liability under the guaranty.

Taxpayer thereupon made a proposition to the Bank that he would pay off his obligation under the guaranty provided the Bank would extend to him certain accommodations and would take his note for $250,000 properly secured, in full settlement. The Bank considered the taxpayer's proposition and finally accepted it and agreed to take his note for $250,000 in full settlement of his prior obligation under the guaranty, represented by his own note for $125,000 and his endorsement on C. W. Gold's note in the same amount.

37 Accordingly, taxpayer executed his note for $250,000 and delivered it to the Bank, and the Bank delivered to him the two notes marked paid and relieved him of all further liability under the guaranty. Both the taxpayer and the Bank understood that this was to be a final settlement and payment of his prior obligation under the guaranty, and the transaction was so treated on the books of the Bank, as well as on taxpayer's records.

C. W. Gold died insolvent in 1932, but the condition of his estate was not definitely known until his executor's report was made in 1933, and taxpayer continued to look for reimbursement from Mr. Gold's estate until 1933.

Taxpayer, accordingly, in his return for 1932, claimed a deduction of $125,000 on account of the loss arising under his guaranty to the Bank. No loss was claimed in 1932 as to C. W. Gold's part of the guaranty because the taxpayer's claim for contribution and reimbursement from C. W. Gold's estate was still outstanding.

In 1933 it was definitely ascertained that C. W. Gold's estate was wholly insolvent and that taxpayer's claim for contribution was worthless. Taxpayer, accordingly, claimed a deduction in his return for 1933 of $125,000 on account of C. W. Gold's note

which he held, and that loss was allowed by the Commissioner as a proper deduction for 1933.

Subsequently, however, the Commissioner disallowed the loss of $125,000 claimed by petitioner in his return for 1932, upon the theory that the entire loss occurred in 1931, notwithstanding the fact that the Commissioner had also allowed the loss on the C. W. Gold note for 1933.

38 The North Carolina Bank & Trust Co. went into receivership in 1933, and in November 1933 taxpayer's note for $250,000 was sold by the Bank's Receiver to Ethel Clay Price and Kathleen Price Bryan, wife and daughter of taxpayer, in exchange for $250,000 in bonds of North Carolina B. & T. Buildings, Inc., a subsidiary of the North Carolina Bank & Trust Co. Taxpayer's note is now held by Mr. Bryan as trustee for Mrs. Price and Mrs. Bryan.

In the proceeding before the Board the taxpayer contended that his loss under his guaranty of the assets of Atlantic Bank & Trust Co. became definite and fixed in March 1932, when he was called upon by the Bank for the first time for payment of his liability thereunder: that taxpayer made a proposition to the Bank to pay off his obligation under the guaranty by giving to the Bank his own secured note for $250,000 under certain terms and conditions: that his proposition was accepted by the Bank and his liability under the guaranty finally settled and paid in full and all further obligation wiped out, and it was so treated and considered both by the Bank and by the taxpayer—that taxpayer's loss thereby became fixed and determined and his estate reduced accordingly by that amount, and hence that the loss was sustained at that time.

The Commissioner contended first that the loss occurred in 1931, because the Class B assets had so declined in value that the Bank called upon taxpayer and the other guarantors to execute their notes for $125,000 each in June 1931, and therefore the loss was fixed at that time. On the other hand, the Commissioner contended next that the loss has not yet occurred because the taxpayer merely renewed or substituted a new note of

39 $250,000 in lieu of two prior notes for $125,000 each, and hence, under the rule in Eckert v. Burnet, 280 U. S. 140, the loss will not occur until the taxpayer pays the latter note.

The Board found as facts that the Class B assets became worthless in 1932: that the taxpayer's liability under the guaranty became fixed and determined when that fact became known and the Bank called upon taxpayer for payment under his guaranty in March 1932; and that the two notes for $125,000 each which were executed pursuant to the guaranty, were paid when tax-

payer's offer was accepted by the Bank and his secured note for $250,000 was taken by the Bank and the two prior notes delivered to taxpayer in March 1932. Nevertheless and notwithstanding these findings of fact as to the payment and discharge of the prior obligation, the Board held that taxpayer could not deduct the loss in 1932 because taxpayer did not part with cash at that time. Citing Eckert v. Burnet, 283 U. S. 140, as its authority.

IV

Taxpayer states that in the record and proceeding before the Board of Tax Appeals and in the decision and final order of its determination entered by the Board, manifest error occurred and intervened to the prejudice of the taxpayer, and the taxpayer accordingly assigns the following errors which he avers occurred in said record, proceeding, decision, and final order entered by the Board, to wit:

1. The Board erred in failing to decide the case upon the basis of its own findings of fact.

2. The Board erred in holding that the payment of taxpayer's obligation under the guaranty did not result in a deductible loss in 1932, within the meaning of the revenue acts.

3. The Board erred in holding that the payment of the two notes representing taxpayer's obligation under the guaranty did not result in a deductible loss in 1932, within the meaning of the revenue acts.

4. The Board erred in holding that the acceptance by the Bank of taxpayer's offer of settlement of his liability under the guaranty, and the execution and delivery of taxpayer's secured note for $250,000, pursuant to said settlement, did not result in a deductible loss to the taxpayer in 1932.

5. The Board erred in holding that the transaction between the taxpayer and the Bank, which the Board has found as a fact, constituted payment and discharge of the taxpayer's obligation under the guaranty, did not result in a deductible loss in 1932.

6. The Board erred in holding that the payment of an obligation by a taxpayer does not result in a loss unless the payment is made in cash.

7. The Board erred in holding that no loss was deductible under the circumstances, notwithstanding the fact that the Bank agreed to accept taxpayer's secured note as payment and discharge of his prior obligation to the Bank, and both parties treated the transaction as payment in their accounts and records.

8. The Board erred in holding that even though the transaction constituted payment and discharge of petitioner's prior obligation under well-established principles of general law, neverthe-

less it did not result in a deductible loss, because taxpayer did not part with cash.

41 9. The Board erred in holding in effect that a taxpayer can not use money borrowed from a bank on his own secured note, to pay and discharge his liability as guarantor under an entirely different obligation to that bank.

10. The Board erred in deciding the case upon the authority of Eckert v. Burnet, supra.

11. The Board erred in failing to hold that the payment and discharge of taxpayer's contingent liability under the guaranty through the acceptance, by the Bank, of a new and entirely different obligation, did not result in a deductible loss in 1932.

12. The Board erred in failing to decide the case for the taxpayer upon the facts of record.

Wherefore, the taxpayer petitions that the decision and final order of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Fourth Circuit; that a transcript of the record be transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by the said Court.

(S) C. R. WHARTON.
C. R. Wharton,
(S) D. H. BLAIR.
D. H. Blair,
(S) G. D. BRABSON.
G. D. Brabson,

404 Transportation Building, Washington, D. C.,
Counsel for petitioner.

42 [*Duly sworn to by Julian Price; jurat omitted in printing.*]

43 In United States Circuit Court of Appeals for the Fourth Circuit

[Title omitted.]

Notice of filing petition for review

Filed Feb. 6, 1939

To Honorable GUY T. HELVERING,
Commissioner of Internal Revenue, Washington, D. C.

SIR: You are hereby notified that the above-named petitioner did, on the 6th day of February 1939, file with the Clerk of the United States Board of Tax Appeals of Washington, D. C., a

Petition for Review by the United States Circuit Court of Appeals for the Fourth Circuit, of the Decision of the Board heretofore rendered in the above-entitled case. A copy of the Petition for Review and the assignments of error as filed, is hereto attached and served upon you.

C. R. WHARTON.
C. R. Wharton.
D. H. BLAIR.
D. H. Blair.
GEO. D. BRABSON.
George D. Brabson.
404 Transportation Building, Washington, D. C.
Counsel for Petitioner on Review.

Personal service of the above and foregoing notice, together with copy of the Petition for Review and assignments of error mentioned therein, is hereby acknowledged this 6th day of February 1939.

(S) J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

44 In United States Circuit Court of Appeals for the Fourth Circuit

[Title omitted.]
[File endorsement omitted.]

Designation of points to be urged

Filed April 7, 1939

To Honorable GUY T. HELVERING,
Commissioner of Internal Revenue, Washington, D. C.

You are hereby notified that the petitioner on review hereby designates the following points which are to be urged upon appeal of this case;

1. The Board erred in failing to decide the case upon the basis of its own findings of fact.

2. The Board erred in holding that the payment of taxpayer's obligation under the guaranty did not result in a deductible loss in 1932, within the meaning of the revenue acts.

3. The Board erred in holding that the payment of the two notes representing taxpayer's obligation under the guaranty did not result in a deductible loss in 1932, within the meaning of the revenue acts.

4. The Board erred in holding that the acceptance by the Bank of taxpayer's offer of settlement of his liability under the guaranty, and the execution and delivery of taxpayer's secured
45 note for $250,000, pursuant to said settlement, did not result in a deductible loss to the taxpayer in 1932.

5. The Board erred in holding that the transaction between the taxpayer and the Bank, which the Board has found as a fact, constituted payment and discharge of the taxpayer's obligation under the guaranty, did not result in a deductible loss in 1932.

6. The Board erred in holding that the payment of an obligation by a taxpayer does not result in a loss unless the payment is made in cash.

7. The Board erred in holding that no loss was deductible under the circumstances, notwithstanding the fact that the Bank agreed to accept taxpayer's secured note as payment and discharge of his prior obligation to the Bank, and both parties treated the transaction as payment in their accounts and records.

8. The Board erred in holding that even though the transaction constituted payment and discharge of petitioner's prior obligation under well-established principles of general law, nevertheless it did not result in a deductible loss, because taxpayer did not part with cash.

9. The Board erred in holding in effect that a taxpayer cannot use money borrowed from a bank on his own secured note, to pay and discharge his liability as guarantor under an entirely different obligation to that bank.

10. The Board erred in deciding the case upon the authority of Eckert v. Burnet, 280 U. S. 140.

11. The Board erred in failing to hold that the payment and discharge of taxpayer's contingent liability under the
46 guaranty through the acceptance, by the Bank, of a new and entirely different obligation, did not result in a deductible loss in 1932.

12. The Board erred in failing to decide the case for the taxpayer upon the facts of record.

Respectfully,

GEO. D. BRABSON,
Counsel.

Service of a copy of the above Desiguation is hereby acknowledged this 7th day of April 1939.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

47 In United States Circuit Court of Appeals for the Fourth Circuit

[Title omitted.]

Praecipe for record

Filed April 6, 1939

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Fourth Circuit, two copies duly certified as correct of the following documents and records in the above-entitled cause, in connection with the Petition for Review by the said Circuit Court of Appeals for the Fourth Circuit, heretofore filed by the above-named petitioner:

1. Documentary entries of all proceedings before the Board.

2. Pleadings before the Board, including: (a) Petition and annexed copy of deficiency notice; (b) Answer.

3. Opinion and decision of the Board.

4. Petitioner's motion for reconsideration by the entire Board, and order of the Board denying the motion. (Not of record.)

48 5. Petition for Review, together with proof of service of notice of filing Petition for Review and of service of a copy of the Petition for Review.

6. Orders, if any, enlarging the time for preparation of the record and transmission and delivery of the record not included in record.

7. This praecipe.

8. Designation of points to be urged.

(Sgd.) GEORGE D. BRABSON.
George D. Brabson.
Transportation Building, Washington, D. C.,
Attorney for Petitioner on Review.

Service of a copy of the within praecipe is hereby admitted this 6th day of April 1939. Agreed to.

(Sgd.) J. P. WENCHEL,
Attorney for Respondent on Review.

49 [Clerk's certificate to foregoing transcript omitted in printing.]

50 **In United States Circuit Court of Appeals for the Fourth Circuit**

No. 4480

JULIAN PRICE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition to Review the Decision of the United States Board of Tax Appeals

April 24, 1939, the transcript of record is filed and the cause docketed.

Certified copy of order enlarging time to file record

Filed April 24, 1939

For cause appearing of record, it is ordered: That the time for transmission and delivery of the record sur petition for review of the above entitled proceeding by the United States Circuit Court of Appeals, Fourth Circuit, be, and it is hereby, extended to May 1, 1939.

(S) C. R. ARUNDELL,
Member.

Dated: Wash., D. C., April 7, 1939.

Now, April 22, 1939, the foregoing is certified from the record as a true copy.

[SEAL]

B. D. GAMBLE,
B. D. Gamble, *Clerk,*
U. S. Board of Tax Appeals.

51 April 26, 1939, the appearance of Julius C. Smith and C. R. Wharton is entered for the petitioner.

Same day, the appearance of James W. Morris, Assistant Attorney General, and Sewall Key, Special Assistant to the Attorney General, is entered for the respondent.

April 27, 1939, the appearance of D. H. Blair and Geo. D. Brabson is entered for the petitioner.

May 23, 1939, brief and appendix on behalf of the petitioner filed.

June 8, 1939, the appearance of Berryman Green, Special Assistant to the Attorney General, is entered for the respondent.

Same day, brief on behalf of respondent filed.

June 26, 1939, reply brief on behalf of petitioner filed.

In United States Circuit Court of Appeals

Minute entry of argument and submission

June 29, 1939 (June term, 1939), cause came on to be heard before Parker and Northcott, Circuit Judges, and H. H. Watkins, District Judge, and is argued by counsel and submitted.

July 21, 1939, motion to withdraw appearance of James W. Morris, Assistant Attorney General, is filed.

In United States Circuit Court of Appeals

Order granting motion to withdraw appearance of James W. Morris, Assistant Attorney General

Filed July 24, 1939

On motion of the respondent in the above entitled
52 cases to withdraw the appearance of James W. Morris, as counsel for said Respondent, in view of the fact that Mr. Morris has resigned as Assistant Attorney General, and is now an Associate Justice of the United States District Court for the District of Columbia,

It is ordered by this Court that said motion be, and the same is hereby, granted, and that the appearance of James W. Morris be withdrawn as counsel for the Respondent in the above entitled cases.

July 22, 1939. JOHN J. PARKER,
Senior Circuit Judge.

53 In United States Circuit Court of Appeals,
Fourth Circuit

No. 4480

JULIAN PRICE, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition to Review the Decision of the United States Board of Tax Appeals

(Argued June 29, 1939. Decided August 28, 1939)

Before PARKER and NORTHCOTT, Circuit Judges, and H. H. WATKINS, District Judge

George D. Brabson and Julius C. Smith (C. R. Wharton, and D. H. Blair on brief) for Petitioner, and Berryman Green, Spe-

cial Assistant to the Attorney General (Sewall Key, Special Assistant to the Attorney General, on brief), for Respondent.

Opinion

Filed August 28, 1939

PARKER, Circuit Judge:

This is a petition to review a decision of the Board of Tax Appeals, approving a deficiency assessment for the year
54 1932. The question involved relates to the deductibility of a loss which taxpayer claims to have sustained in that year on a contract of guaranty previously executed. The Board denied the deduction on the ground that taxpayer, who made his return on the cash receipts and disbursements basis, gave a note covering the loss and that this note was not paid until the year following.

The taxpayer, Julian Price, is president of the Jefferson Standard Life Insurance Company, which in the year 1929 was a large stockholder in the Atlantic Bank and Trust Company of Greensboro, N. C. In September 1929 the last-named institution was merged with the North Carolina Bank and Trust Company; and pursuant to the plan of merger certain assets of the Atlantic Bank, called "A" assets, were accepted conditionally by the North Carolina Bank, and certain other assets, called "B" assets, were pledged to that bank with authority to charge against them any losses which might be established in the "A" assets. At the same time, taxpayer and three other stockholders of the Atlantic Bank executed a guaranty agreement to the effect that, if the North Carolina Bank failed to realize a certain sum from the "A" assets within two years, they would make up the deficiency so ascertained in an amount not exceeding $500,000.00. The period for realizing on the "A" assets under the terms of the guaranty was subsequently extended for an additional year, or until sometime within the year 1932.

In June 1931 the president of the North Carolina Bank advised the four guarantors that the "B" assets were not in such shape that the bank could use them to the extent necessary for banking purposes, and requested them to put their guaranty into bankable form so that it could be used by the bank to obtain credit. Whereupon taxpayer executed and delivered to the bank his note for $125,000.00 and indorsed the note of C. W. Gold, another one of the guarantors, for a like amount. He also borrowed from his wife certain stocks which he deposited as collateral security to the notes. At this time, the "B" assets
55 were still pledged as security for realization on the "A"

assets; and in August 1931 they were valued upon an appraisal at $529,947.44, or an amount in excess of the guaranty made by taxpayer and his fellow guarantors. The Board finds that: "At the end of 1931, the guaranty agreement was still in force and effect. The 'B' assets were still in the hands of the North Carolina Bank, as trustee, and were still in the process of collection. No demand had ever been made upon petitioner for the payment of any part of his obligation under the guaranty. While it was known that there would be some loss to the guarantors, it was not definitely known throughout 1931 what the amount of the loss would be, and the guarantors had every reason to believe there would be a substantial reimbursement from the 'B' assets of any losses."

Financial conditions in Greensboro took a turn for the worse in the early part of 1932, collections on the "A" and "B" assets declined, and it was soon apparent that there was no possibility of recovering anything further from the "B" assets. Consequently the North Carolina Bank decided to make collection on the guaranty as to the "A" assets, and called the guarantors to make good their guaranty. Taxpayer, thereupon, executed his note for $250,000.00 to the bank in settlement of his liability and that of Mr. Gold, upon whose note he was indorser; and the finding of the Board with respect to this crucial matter is as follows:

"In the latter part of March 1932, petitioner, in his discussions with officials of the North Carolina bank, was informed that the bank had decided that the possibilities of collecting anything on the 'B' assets were remote and that there was no hope of any relief from these assets. The bank requested that petitioner make a final settlement of his obligation under the two notes and the guaranty to the bank. Petitioner proposed to pay the two notes (his own note and Gold's note on which he was endorser) by giving the bank his note for $250,000. The
56 bank accepted, and the C. W. Gold note in the amount of $125,000, endorsed by petitioner, and petitioner's individual note in the same amount were paid by the note of petitioner in the amount of $250,000, dated March 28, 1932. Upon the delivery of this note for $250,000 the bank marked 'paid' and turned over to petitioner the two notes which had been executed under the guaranty agreement. Both petitioner and the bank considered this to be a final payment of the two notes given under the guaranty."

Taxpayer at first deposited as collateral with the $250,000 note the stocks which he had borrowed from his wife and deposited as collateral to the accommodation notes given by himself and Gold in the preceding year. In the following December, how-

ever, he substituted securities of his own in lieu of these. In November 1933, the note was transferred by the Conservator of the Bank to taxpayer's wife and daughter and was held by an agent as trustee for them at the time of the hearing before the Board.

Taxpayer deducted only $125,000 as a loss on account of this transaction in 1932, that being his individual loss as guarantor; and the propriety of that deduction is the only matter before us. The $125,000 that he paid on account of his indorsement for C. W. Gold he deducted as a loss in 1933; and that deduction is not here in controversy. As to the propriety of deferring the latter deduction until 1933, it appears that Gold died in 1932 and it was necessary for taxpayer to look to his estate for reimbursement. Not until 1933 did it become apparent that the estate was insolvent and that taxpayer could expect no reimbursement therefrom.

Upon these facts the only question that arises in the case is when did the taxpayer sustain the $125,000 loss on his guaranty. We think it clear that he sustained it in 1932. He did not sustain it in 1931, because at that time it was not definitely ascertained that he would sustain a loss, or, if so, what the loss would be. He did not sustain it when he paid the note; for that was but the payment of a debt incurred when the loss was
57 sustained, and we have recently held that the payment of a debt results in no deductible loss. U. S. v. Little War Creek Coal Co., 4 Cir. 104 F. 2d 483.

How a deductible loss must be evidenced is thus set forth in Regulations 86, Article 23 (e): "In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed." And see Rhodes v. Commissioner, 6 Cir. 100 F. 2d 966, 969. The loss sustained by the taxpayer in 1932 falls squarely within the terms of this regulation. The guaranty given the bank and the payment thereunder were closed and completed transactions. The closing was fixed by an identifiable event, viz. the giving of the $250,000 note as the primary obligation of the taxpayer, and not as a mere guaranty or accommodation, and the surrender of the two notes which had been executed under the guaranty agreement. There can be no question as to the loss being "bona fide and actually sustained" within the period. The Board finds that "The bank requested that petitioner make a final settlement of his obligation under the two notes and the guaranty to the bank," and that, when petitioner delivered his note for $250,000 and the bank turned over to him the two notes which had been executed under the guaranty agreement, "Both

petitioner and the bank considered this to be a final payment of the two notes given under the guaranty." Prior to this transaction taxpayer was liable on his guaranty and on the two notes given as accommodation thereunder; but his loss under the guaranty had never been determined and his liability was of a secondary character, for even on the notes executed in 1931 he was liable only as an accommodation maker. In giving the $250,000 note, however, he faced realities and accepted his loss. His liability on the note thus executed was primary and unconditional.

58 The fact that taxpayer instead of meeting his loss with a cash payment gave a note in settlement, does not change the situation as to when the loss occurred; for the giving of the note could not postpone the loss. The loss was accepted and the note given created a bona fide indebtedness of an entirely different character from that which had theretofore existed. It will not do to say that taxpayer sustained the loss when he paid the debt and not when he incurred it for the purpose of meeting the loss: for one does not sustain a loss by merely paying a debt for which he himself is primarily liable, nor is the loss deferred by contracting a debt with which to pay it. The able attorney representing the Commissioner very properly admitted on the argument that, if taxpayer had obtained the $250,000 to meet the loss by giving the note to another bank, he would have been entitled to the deduction claimed; but surely his right to the deduction cannot depend upon the identity of the bank which extends credit to him.

It is argued that the fact that taxpayer is on the cash receipts and disbursements basis instead of the accrual basis makes a difference; but we do not think so. The question is not one of accruing a loss to occur in the future, but of dealing with a loss that has already occurred; and, as heretofore stated, the occurrence of the loss cannot be said to be postponed merely because credit is obtained with which to meet it. This seems very clear if a simple illustration be taken: If A and B, indorsers on the note of an insolvent corporation, are called for payment, and A discharges his half of the liability in cash while B gives his individual note, payable in the following year but amply secured (as was the case here) in discharge of his liability, can it be said that the loss is sustained by A in one year and B in the next? To ask the question is to answer it. Any such rule would not only shock the common sense of practical men, but would also put it within the power of a taxpayer to spread losses of this character over a number of years, by the simple expedient of giving

59 a note or notes in settlement of the loss and claiming deductions as the notes are paid.

There is a difference, of course, between a m[illegible] postponing of a pending loss on a secondary obligation and n[illegible]eting the loss, as the taxpayer did here, with the execution of a primary obligation. In the one case, the loss may never be sustained; in the other, it is sustained when the primary obligation is given. True, a taxpayer on the cash receipts and disbursements basis cannot be said to have sustained a loss until he has parted with money or money's worth; but when he executes a bankable note, secured by collateral, he has parted with money's worth. The value of his estate is decreased by the amount of the note as a result of the transaction.

The facts of the case, in final analysis, amount to a borrowing by taxpayer from the bank of funds with which to meet the liability on his guaranty and the application of the proceeds of the loan to that purpose; and we know of no principle of law or of justice which would deny him the right to deduct the loss arising from his guaranty until the loan is repaid. A case very much in point is Crain v. Commissioner, 8 Cir. 75 F. 2d 962. In that case taxpayer and another became obligated to pay obligations of a corporation in which they were stockholders in the sum of $80,000. In 1916 the other person paid the $80,000 in cash and took taxpayer's note for $40,000, which taxpayer did not pay until 1919. Taxpayer sought to take deduction for his part of the loss in the year 1919 when he paid the note. In holding that he might not do this, the court said:

"But in the year 1916, the amount of loss sustained became definitely certain, and the whole of it was actually paid by Wesson. Since the taxpayer did not himself have on hand enough cash to pay his half, he agreed with Wesson that the latter should advance all of the money in payment of the loss, and the taxpayer would make to Wesson a note for the taxpayer's half of such loss.

60 "In fair effect, what the taxpayer did in 1916 was to borrow $40,000 in money with which to pay the loss, now here in dispute, as to the date of its accrual for taxing purposes. It seems clear, from the facts here and the ruled cases, that the loss occurred in 1916. Avery v. Commissioner, C. C. A., 22 F. 2d 6, 55 A. L. R. 1277; Darling v. Commissioner, C. C. A., 49 F. 2d 111. Did the giving of the note to Wesson have the effect to lawfully postpone deduction of the loss from income till the year in which the note was paid?

* * * * * * *

"If the taxpayer had himself actually paid in cash his part of the loss in 1916 it would hardly be contended that he could not in that year have charged the sum paid as a proper deduction from

his income for that year. It is difficult to see how the situation was changed merely because he was forced to borrow money from another with which to pay his part of the loss."

Another case very much in point is Jenkins v. Smith, 21 F. Supp. 433. In that case a taxpayer had executed a bond to a bank in precarious condition guaranteeing the deposit of collateral which was to become the property of the bank in the event of its insolvency. The bank became insolvent and its affairs were taken over by another bank, which called upon taxpayer to make good his obligation under the bond. He thereupon executed his note to the last-named bank to borrow a sufficient sum to meet the obligation and gave his check in extinguishment thereof. It was held that a deductible loss resulted. The court said:

"The deduction was proper and plaintiffs must prevail if, under all the circumstances, the obligation on the bond was paid. The defendant urges, however, that there was no payment in fact, but only in form, since the decedent remained obligated to the First National Bank & Trust Company for the same amount, evidenced by a new note. He parted with no cash in 1933, but merely borrowed from his payee in order to pay the same payee.

"In my opinion, the obligation on the bond was dis-
61 charged by the acceptance by the First National of the check as payment. Where or how the decedent obtained the money with which to make the check good is immaterial. The acceptance of the check as payment discharged the obligation, even though it created an overdraft. A new cause of action arose upon the check. The First National could no longer have sued the decedent on the bond. The bank knew of the overdraft, but was satisfied to take its chances on the new obligation. The bond transaction was closed.

"The credit to the decedent's account, made on the same day, was the result of a new transaction, initiated by a promissory note to the bank secured by new collateral. It was in no sense an extension of time for payment of the old debt. It was a new contract of a substantially different nature."

Directly in point is the Board's decision in A. W. D. Weis v. Commissioner, 13 B. T. A. 1284. In that case, as here, taxpayer kept his books on the cash receipts and disbursements basis. A partnership in which he was interested failed in the year 1919, and he was called by a bank for the payment of partnership paper upon which he was liable and gave the bank his personal note, which was renewed from time to time and not paid until 1923. The Board said:

"We are of the opinion that all the losses here in question were sustained in the years in which the several investments became worthless. In such respective years each of the deals became a

closed transaction and the petitioner's net assets were reduced in the amount of the loss sustained. It is not material whether such losses were met by the payment of cash from funds in hand or with cash borrowed from the bank and evidenced by notes payable in a subsequent year. The loss had been sustained and the transaction had been closed by a cash payment. The use of the petitioner's credit to secure funds from the bank was a new and different deal and had no more to do with the petitioner's tax liability than any other borrowing that he did in the taxable year."

62 The Weis case deals with another situation which demonstrates the unsoundness of the general proposition that a taxpayer on a tax receipts and disbursements basis cannot be said to sustain a loss so long as he does not meet the loss with a cash payment. In a transaction separate and distinct from the one described, taxpayer had given his note for $37,500 to a corporation for stock issued to him. The corporation went into bankruptcy in 1921 and taxpayer's investment therein became a total loss in that year although he did not pay the note until 1925. It was held that he was entitled to take deduction for the loss in 1921 and not in 1925.

The chief reliance of the Commissioner is the decision of the Supreme Court in Eckert v. Burnet, 283 U. S. 140; but we do not regard that decision as controlling here. In that case the taxpayer and another were indorsers on paper of a defunct corporation. They executed a joint note to the bank, and destroyed the old notes. Taxpayer sought to deduct half of the sum of these notes as a worthless debt. The court said: "The petitioner treats the case as one of an investment that later turns out to be bad. But in fact it was the satisfaction of an existing obligation of the petitioner, having, it may be, the consequence of a momentary transfer of the old notes to the petitioner in order that they might be destroyed. It is very plain, we think, that the words of the statute cannot be taken to include a case of that kind." The court went on to say further: "As happily stated by the Board of Tax Appeals, the petitioner 'merely exchanged his note under which he was primarily liable for the corporation's notes under which he was secondarily liable, without any outlay of cash or property having a cash value.' A deduction may be permissible in the taxable year in which the petitioner pays cash. The petitioner says that it was definitely ascertained in 1925 that the petitioner would sustain the losses in question. So it was, if the petitioner ultimately pays his note. So was the tax
63 considered in United States v. Mitchell, 271 U. S. 9, 12, but it could not be deducted until it was paid."

We consider this case as definite authority only for the holding that a loss of the character set forth is not deductible under the "bad debt" provision of the statute (Burns Mfg. Co. v. Commissioner, 9 Cir. 59 F. 2d 504, 507), although the language does indeed go further and lay down the proposition that where there is a mere deferring of a loss by the renewing of an obligation, the loss may not be deducted until the obligation is paid, a proposition which we are not disposed to question. That it was not intended to prevent by that decision the taking of a loss in a case such as this, where the loss is evidenced by a closed transaction, but merely to prevent the taking of a supposed loss which has never been realized, is indicated by the decision in Burnet v. Logan, 283 U. S. 404, 413, where the court refers to the Eckert decision as follows: "Ordinarily, at least, a taxpayer may not deduct from gross receipts a supposed loss which in fact is represented by his outstanding note. Eckert v. Commissioner of Internal Revenue, ante, p. 140. And, conversely, a promise to pay indeterminate sums of money is not necessarily taxable income. 'Generally speaking, the income tax law is concerned only with realized losses, as with realized gains.'" In other words, the taxpayer may not take deduction for a loss where what he has done is merely to postpone the evil day of reckoning. He may take the deduction where he has met the evil day and the loss has been realized. The fact that he borrows money to meet it is immaterial; the fact that he borrows to meet an outstanding obligation out of which the loss arises is immaterial; and the fact that he borrows from the person to whom the obligation is due is immaterial, provided that there is, as there was here, a real payment of such obligation in money or money's worth and not a mere extension or renewal.

The Commissioner relies also upon Jenkins v. Bitgood, 2 Cir. 101 F. 2d 17, and Hart v. Commissioner, 1 Cir. 54 F. 64 2d 848. The former relates to the deductibility of losses in stock for which a note was given in payment. It has no applicability to the case at bar except insofar as certain reasoning of the opinion may be persuasive. In this connection, however, we will say that we are not impressed with the reasoning that a taxpayer may not deduct in the year in which it occurs a loss sustained as the result of a purchase of stock, merely because he has given his note for the purchase of the stock payable in a succeeding year. The Hart case deals with the deductibility of interest, where the interest is not in fact paid but a note is given for it. This, of course, is a mere deferring of payment and not at all the sort of thing involved in the transaction before us.

The whole question in the case at bar comes to this: Was there a mere postponement of the loss by the renewal of the existing

obligation? Or was there a realization of the loss by the discharge of the existing obligation and the assumption by taxpayer of an independent obligation of a different character? We think that the latter is the case. The loss arising out of the guaranty given the bank was liquidated and discharged by the taxpayer. He discharged that liability, not with money, but with money's worth, i. e., with his bankable note amply secured by collateral. The case is no different from what it would have been had he borrowed money from another bank on this note and used the proceeds for the purpose for which he used the note itself. The old obligation was not carried forward nor was the taking of the loss postponed. The loss was actually sustained when the liability on the guaranty was met and discharged; and it cannot affect taxpayer's right to deduction on account thereof that he met it by what was in effect a borrowing of money.

For the reasons stated, the decision of the Board will be reversed.

Reversed.

65 In United States Circuit Court of Appeals, Fourth Circuit

No. 4480

JULIAN PRICE, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On petition to Review the Decision of the United States Board of Tax Appeals.

Judgment

Filed and Entered August 28, 1939

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the decision of the said Board of Tax Appeals, in this cause, be, and the same is hereby, reversed; and that this cause be, and the same is hereby, remanded to the United States Board of Tax Appeals for further proceedings in accordance with the opinion of the Court filed herein.

JOHN J. PARKER,
Senior Circuit Judge.

AUGUST 28, 1939.

Recital as to issuance of mandate.

On another day, to wit, September 28, 1939, the mandate of this Court, in this cause, is issued and transmitted to the
66 United States Board of Tax Appeals, at Washington, D. C., in due form.

[Clerk's certificate to foregoing transcript omitted in printing.]

U. S. GOVERNMENT PRINTING OFFICE 1939

Supreme Court of the United States

Order allowing certiorari

Filed January 15, 1940

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE 16—

FILE COPY

NOV 28 1939
CHARLES ELMORE CROPLEY
CLERK

No.— 559

In the Supreme Court of the United States

OCTOBER TERM, 1939

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JULIAN PRICE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

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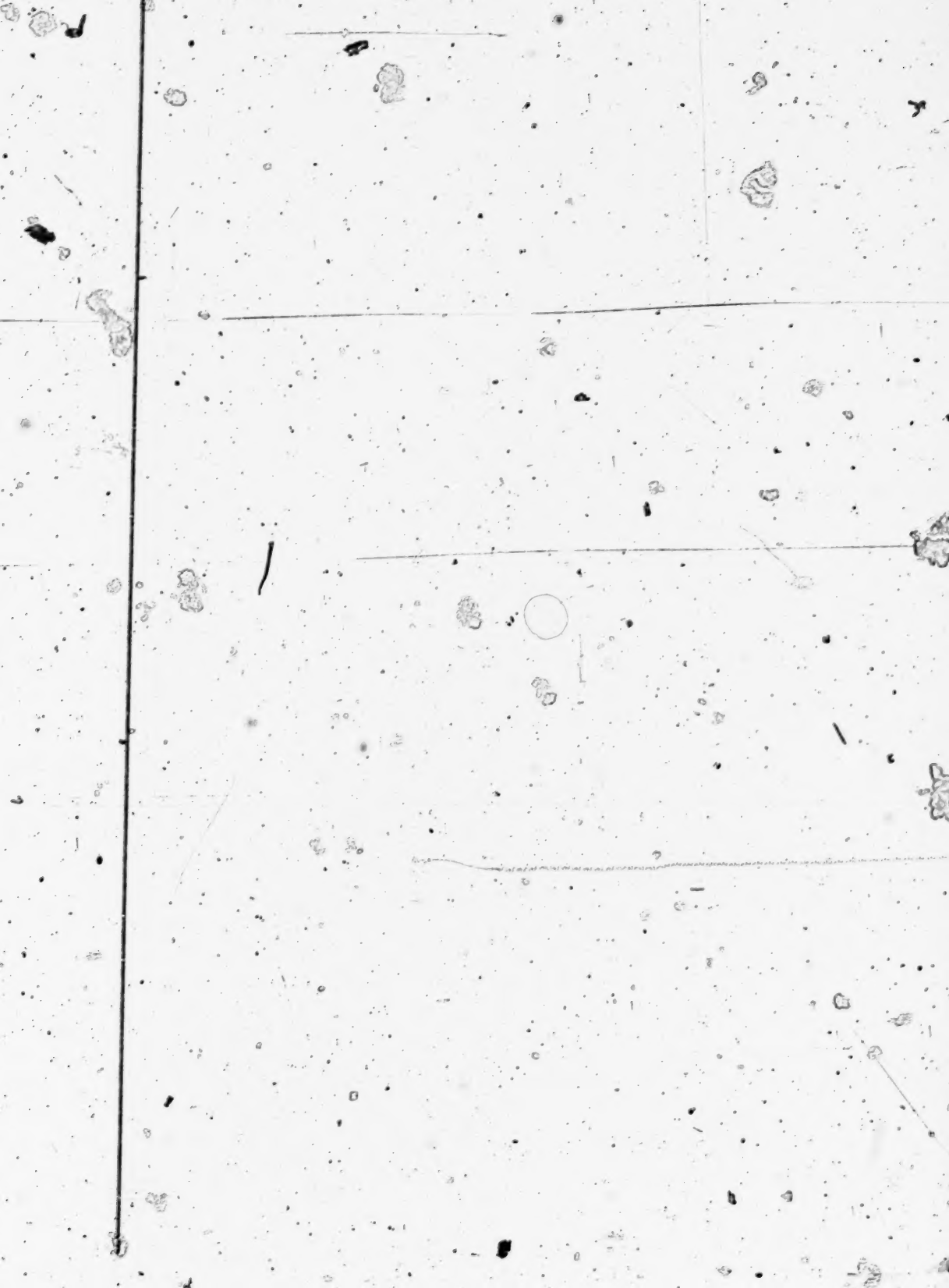

In the Supreme Court of the United States

OCTOBER TERM, 1939

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JULIAN PRICE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit entered in the above cause on August 28, 1939, reversing the decision of the United States Board of Tax Appeals.

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (Tr. 17–29)[1] is not reported. The opin-

[1] Under the rules of the United States Circuit Court of Appeals for the Fourth Circuit there was no printed tran-

ion of the United States Circuit Court of Appeals is reported in 106 F. (2d) 336.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 28, 1939 (Tr. 65). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer, having agreed to guarantee a bank against certain losses, put his guaranty into bankable form at the request of the bank by giving it his own note for $125,000, endorsing a $125,000 note of a co-guarantor and furnishing collateral to secure both notes. In 1932, when the taxpayer's liability on his guaranty became certain, he gave the bank his own note for $250,000 in return for the two $125,000 notes, the new note being secured by the same collateral held by the bank as security for the old notes. The taxpayer made no payment on the $250,000 note during the year 1932.

The question presented is whether the taxpayer, who was on the cash receipts and disbursements basis, is entitled to a deductible loss for the year 1932 on account of his original note of $125,000.

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script of record in the court below, and the record has not yet been printed by the Clerk of this Court. All record references herein are therefore to the original transcript of record.

STATUTE INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) *Losses by Individuals.*—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; * * *.

STATEMENT

The material facts as found by the Board of Tax Appeals (Tr. 18–25) may be summarized as follows:

The taxpayer is a resident of Greensboro, North Carolina. During the year 1929 he was president and a substantial stockholder of the Jefferson Standard Life Insurance Company, which com-

pany was a large stockholder and depositor in the Atlantic Bank and Trust Company of Greensboro. The taxpayer himself was also a stockholder of the Atlantic Bank (Tr. 18).

In September, 1929, the Atlantic Bank was merged with the North Carolina Bank and Trust Company. Under the plan of merger certain assets of the Atlantic Bank, called "A" assets, were accepted conditionally by the North Carolina Bank and certain other assets, called "B" assets, were pledged to that bank with authority to charge against the "B" assets any losses which might be established in realizing the "A" assets. As part of the merger the taxpayer and three other stockholders of the Atlantic Bank executed a guaranty agreement to the effect that, if the North Carolina Bank failed to realize a certain sum from the "A" assets within two years, they would make up the deficiency in an amount not exceeding $500,000. The agreement provided that any sums realized from the "B" assets were to be applied first to any losses occurring in the "A" assets and then to reimbursement of the four guarantors. The period for realizing upon the "A" assets under the terms of the guaranty was subsequently extended with the consent of the guarantors for an additional year, or until September, 1932 (Tr. 18–19).

In June, 1931, the president of the North Carolina Bank advised the guarantors that the "B" assets were not in such shape that the Bank could

use them to the extent necessary for banking purposes, and requested them to put their guaranty into bankable form so that it could be used by the bank to obtain credit. In compliance with this request, the taxpayer executed and delivered to the Bank his note for $125,000 and endorsed the note of C. W. Gold, another one of the guarantors, for a like amount. He also deposited collateral security for the payment of these notes. In consideration for the execution of his own note, the endorsement of Gold's note and the furnishing of the collateral, the Bank agreed that the taxpayer's liability under the guaranty should not be in excess of $250,000 (Tr. 20–21).

At the time of this transaction, the "B" assets were still pledged as security for realization on the "A" assets. In August, 1931, they were valued upon an appraisal at $529,947.44, an amount in excess of the guaranty made by the taxpayer and his co-guarantors. By the end of 1931, however, it became apparent that there would be some loss to the guarantors, although the amount of the loss was not definitely known and the guarantors had every reason to believe that they would receive substantial reimbursement from the "B" assets (Tr. 21).

In the early part of 1932, financial conditions in Greensboro took a turn for the worse, collections on the "A" and "B" assets declined and it soon became apparent that there was no possibility of

recovering anything further from the "B" assets. Consequently, in the latter part of March, 1932, the North Carolina Bank decided to make collection on the guaranty as to the "A" assets, and called upon the guarantors to make good their guaranty (Tr. 22).

The taxpayer thereupon arranged with the Bank to give the Bank his note for $250,000 in settlement of his own liability and that of Mr. Gold, upon whose note he was endorser. Upon the delivery to the Bank of this $250,000 note, the Bank marked "paid" and turned over to the taxpayer the two $125,000 notes which had been executed under the guaranty agreement. The $250,000 note was secured by the same collateral by which the two $125,000 notes had been secured. Both the taxpayer and the Bank considered this to be a final payment of the two notes given under the guaranty (Tr. 22–23).

In his tax return for the year 1932, which was filed on the cash receipts and disbursements basis (Tr. 18), the taxpayer deducted $125,000 as a loss sustained in this transaction, the amount of the deduction being the amount of the note which the taxpayer had executed as maker, as distinguished from the note which he had signed only as endorser.[2] The Commissioner of Internal Revenue

[2] The taxpayer deducted his alleged loss on Gold's note in 1933 and this deduction is not here in controversy. The court below stated with respect to this deduction: "As to the propriety of deferring the latter deduction until 1933, it

disallowed the deduction and determined a deficiency accordingly (Tr. 11–12). The Board of Tax Appeals sustained the deficiency (Tr. 25–30), but the court below reversed, holding that the taxpayer had realized the loss in 1932 and was entitled to the deduction (Tr. 53–64).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the taxpayer, on the cash receipts and disbursements basis, sustained a deductible loss under the guaranty agreement in March, 1932, when he discharged his obligation thereunder by the delivery of his promissory note secured by collateral.

2. In failing to hold that the taxpayer, on the cash receipts and disbursements basis, sustained no deductible loss under the guaranty agreement in March, 1932, when he discharged his obligation thereunder by the delivery of his promissory note secured by collateral.

3. In holding that the execution and delivery of the taxpayer's note and its accompanying collateral in March, 1932, constituted a payment of the taxpayer's loss under the guaranty agreement in "money or money's worth."

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appears that Gold died in 1932 and it was necessary for taxpayer to look to his estate for reimbursement. Not until 1933 did it become apparent that the estate was insolvent and that taxpayer could expect no reimbursement therefrom" (Tr. 56):

4. In failing to hold that the mere execution and delivery of the taxpayer's note and its accompanying collateral in March, 1932, did not constitute a payment of the taxpayer's loss under the guaranty agreement.

5. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision of the court below is in conflict with the decisions of the Circuit Court of Appeals for the Second Circuit in *Jenkins* v. *Bitgood*, 101 F. (2d) 17, certiorari denied, May 22, 1939, No. 892, October Term, 1938,[1] and in *Ferris* v. *Commissioner*, 102 F. (2d) 985, affirming, per curiam, 38 B. T. A. 312. Both of those cases were decided primarily on the authority of *Eckert* v. *Burnet*, 283 U. S. 140, with which the decision below is likewise in conflict.

In *Eckert* v. *Burnet*, *supra*, the taxpayer, who was liable to a bank as endorser of an unsecured note of an insolvent maker, took up the note during the taxable year by substituting his own unsecured note therefor. This Court held that, since the taxpayer was on the cash basis, he could not

[1] The taxpayer in *Jenkins* v. *Bitgood*, *supra*, moved this Court for leave to file a petition for rehearing of the petition for certiorari, asserting that the decision of the Circuit Court of Appeals for the Second Circuit in that case is in conflict with the decision of the court below in the instant case. The denial of that motion ~~on November 22, 1939,~~ would be however, ~~was plainly~~ justified for it had not been filed during the term of court in which the original petition had been denied.

deduct the amount of the old note as a worthless debt. The Court pointed out that the taxpayer had made no expenditure during the taxable year of cash or of property having a cash value and consequently, on the cash basis, had realized no loss and would realize no loss until the note was paid.

The *Eckert* case was the principal authority relied upon by the Circuit Court of Appeals for the Second Circuit in deciding *Jenkins* v. *Bitgood, supra.* There the taxpayer had sought to protect his investment in bank stock by purchasing depreciated bonds from the bank at prices in excess of market value, giving his secured promissory note in payment of the purchase price. When the bank stock subsequently became worthless, the taxpayer deducted as a loss not only the purchase price of the stock but also the difference between the purchase price and the market value of the bonds which he had bought from the bank, on the theory that this difference represented a contribution made by him to the capital of the bank to protect his investment in its stock. The court, while holding that this difference was a capital contribution, nevertheless denied the deduction on the ground that, on the cash basis, no deductible loss would be realized until the purchase money note was paid. Relying on the *Eckert* decision, the court pointed out the difference between the deductibility, on the cash basis, of a contribution to capital requiring the expenditure of cash or property having a cash value, and of a contribution consisting merely of a promissory

note, as yet unpaid. The fact that the *Eckert* case involved an unsecured note and a claim of deduction for a worthless debt, whereas the case then before it involved a secured note and a claim of deduction for an investment loss, was considered immaterial.

In *Ferris* v. *Commissioner, supra,* the taxpayer was liable as an endorser on a note of many years' standing held by a bank. During the taxable year, the taxpayer gave the bank his own note for an amount sufficient to discharge the original note, the bank credited the taxpayer's account with this amount, and the taxpayer then gave the bank his check in the same amount in satisfaction of the original note. The taxpayer was not permitteed to deduct the amount of the original note, either as a bad debt or as a loss, since he had in effect discharged the old obligation merely by the issuance of the new note, and therefore, on the cash basis, would realize a loss only when the new note was paid.

The principle underlying all of these cases is that, on the cash basis, no deductible loss can result from the execution of a promissory note, whether secured or not, until the note is paid. The decision of the court below, disregarding this principle, in effect obliterates the fundamental distinction between taxation on the cash and on the accrual bases of accounting. The execution and delivery of the taxpayer's note in this case in satisfaction of his

obligation under the guaranty agreement and the notes given pursuant to the guaranty agreement, did not in any way affect the taxpayer's financial position on a cash basis; he neither suffered a loss on an investment for which he had previously paid cash nor was he required to pay cash during the taxable year to satisfy losses from a transaction previously entered into. Only on the accrual theory of accounting was a loss sustained. But the taxpayer did not employ the accrual system of accounting. He kept his books on the cash basis, and Section 41 of the Revenue Act of 1932, *supra*, p. 3, requires that the net income shall be computed "in accordance with the method of accounting regularly employed in keeping the books of such taxpayer."

2. Because the decision below obliterates the distinction between the cash and accrual bases of accounting it will, unless reviewed by this Court, lead to serious confusion in the administration of the revenue acts. Determination of the question by this Court is important for the guidance of the Government and of taxpayers in future cases.

CONCLUSION

It is respectfully submitted that this petition for a writ of certiorari should be granted.

ROBERT H. JACKSON,
Solicitor General.

NOVEMBER 1939.

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Supreme Court, U. S.
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No. 559

In the Supreme Court of the United States

OCTOBER TERM, 1939

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JULIAN PRICE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE PETITIONER

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OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 11–19) is not reported. The opinion of the Circuit Court of Appeals (R. 32–41) is reported in 106 F. (2d) 336.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 28, 1939. (R. 41.) The petition for a writ of certiorari was filed November 28, 1939, and was granted January 15, 1940. The ju-

risdiction of this Court is conferred by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer, having agreed to guarantee a bank against certain losses, put his guaranty into bankable form at the request of the bank by giving it his own note for $125,000, endorsing a $125,000 note of a co-guarantor and furnishing collateral to secure both notes. In 1932, when the taxpayer's liability on his guaranty became certain, he gave the bank his own note for $250,000 in return for the two $125,000 notes, the new note being secured by the same collateral held by the bank as security for the old notes. The taxpayer made no payment on the $250,000 note during the year 1932.

The question presented is whether the taxpayer, who was on the cash receipts and disbursements basis, is entitled to a deductible loss for the year 1932 on account of his original note of $125,000.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * * *
>
> (e) *Losses by Individuals.*—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and

not compensated for by insurance or otherwise—.

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business;

* * * * *

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; * * *.

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

Regulations 77, promulgated under the Revenue Act of 1932:

ART. 322. *Bases of computation.*—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with

reasonable consistency. See section 48 for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. (See sections 42, 43, and 48). For instance, in any case in which it is necessary to use an inventory, no accounting in regard to purchases and sales will correctly reflect income except an accrual method. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. (See articles 332 and 333.) On the other hand, appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property. But see article 105.

STATEMENT

The material facts as found by the Board of Tax Appeals (R. 12–17) may be summarized as follows:

The taxpayer is a resident of Greensboro, North Carolina. During the year 1929 he was president and a substantial stockholder of the Jefferson Standard Life Insurance Company, which company was a large stockholder and depositor in the Atlantic Bank and Trust Company of Greensboro.

The taxpayer himself was also a stockholder of the Atlantic Bank. (R. 12.)

In September, 1929, the Atlantic Bank was merged with several banks and trust companies under the name of North Carolina Bank and Trust Company. Under the plan of merger certain assets of the Atlantic Bank, called "A" assets, were accepted conditionally by the North Carolina Bank and certain other assets, called "B" assets, were pledged to that bank with authority to charge against the "B" assets any losses which might be established in realizing upon the "A" assets. As part of the merger the taxpayer and three other stockholders of the Atlantic Bank executed a guaranty agreement to the effect that, if the North Carolina Bank failed to realize a certain sum from the "A" assets within two years, they would make up the deficiency in an amount not exceeding $500,000. The agreement provided that any sums realized from the "B" assets were to be applied first to any losses occurring in the "A" assets and then to reimbursement of the four guarantors. The period for realizing upon the "A" assets under the terms of the guaranty was subsequently extended with the consent of the guarantors for an additional year, or until September, 1932. (R. 12–13.)

In June, 1931, the president of the North Carolina Bank advised the guarantors that the "B" assets were not in such shape that the Bank could use them to the extent necessary for banking pur-

poses, and requested them to put their guaranty into bankable form so that it could be used by the Bank to obtain credit. In compliance with this request, the taxpayer executed and delivered to the Bank his note for $125,000 and endorsed the note of C. W. Gold, another one of the guarantors, for a like amount. He also deposited collateral security for the payment of these notes. In consideration for the execution of his own notes, the endorsement of Gold's note and the furnishing of the collateral, the Bank agreed that the taxpayer's liability under the guaranty should not be in excess of $250,000. (R. 13–14.)

At the time of this transaction, the "B" assets were still pledged as security for realization on the "A" assets. In August, 1931, they were valued upon an appraisal at $529,947.44, an amount in excess of the guaranty made by the taxpayer and his co-guarantors. By the end of 1931, however, it became apparent that there would be some loss to the guarantors, although the amount of the loss was not definitely known and the guarantors had every reason to believe that they would receive substantial reimbursement from the "B" assets. (R. 14–15.)

In the early part of 1932, financial conditions in Greensboro took a turn for the worse, collections on the "A" and "B" assets declined and it soon became apparent that there was no possibility of recovering anything further from the "B" assets.

Consequently, in the latter part of March, 1932, the North Carolina Bank decided to make collection on the guaranty as to the "A" assets, and called upon the guarantors to make good their guaranty. (R. 15.)

The taxpayer thereupon arranged with the Bank to give the Bank his note for $250,000 in settlement of his own liability and that of Mr. Gold, upon whose note he was endorser. Upon the delivery to the Bank of this $250,000 note, the Bank marked "paid" and turned over to the taxpayer the two $125,000 notes which had been executed under the guaranty agreement. The $250,000 note was secured by the same collateral by which the two $125,000 notes had been secured. Both the taxpayer and the Bank considered this to be a final payment of the two notes given under the guaranty. (R. 15.)

In his tax return for the year 1932, which was filed on the cash receipts and disbursements basis (R. 12), the taxpayer deducted $125,000 as a loss sustained in this transaction, the amount of the deduction being the amount of the note which the taxpayer had executed as maker, as distinguished from the note which he had signed only as endorser.[1] The Commissioner of Internal Revenue

[1] The taxpayer deducted his alleged loss on Gold's note in 1933 and this deduction is not here in controversy. The court below stated with respect to this deduction: "As to the propriety of deferring the latter deduction until 1933, it appears that Gold died in 1932 and it was necessary for taxpayer to look to his estate for reimbursement. Not until

disallowed the deduction and determined a deficiency accordingly. (R. 7–8.) The Board of Tax Appeals sustained the deficiency (R. 17–20), but the court below reversed, holding that the taxpayer had realized the loss in 1932 and was entitled to the deduction. (R. 33–41.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the taxpayer, on the cash receipts and disbursements basis, sustained a deductible loss under the guaranty agreement in March, 1932, when he discharged his obligation thereunder by the delivery of his promissory note secured by collateral.

2. In failing to hold that the taxpayer, on the cash receipts and disbursements basis, sustained no deductible loss under the guaranty agreement in March, 1932, when he discharged his obligation thereunder by the delivery of his promissory note secured by collateral.

3. In holding that the execution and delivery of the taxpayer's note and its accompanying collateral in March, 1932, constituted a payment of the taxpayer's loss under the guaranty agreement in "money or money's worth."

4. In failing to hold that the mere execution and delivery of the taxpayer's note and its accompany-

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1933 did it become apparent that the estate was insolvent and that taxpayer could expect no reimbursement therefrom." (R. 34–35.)

ing collateral in March, 1932, did not constitute a payment of the taxpayer's loss under the guaranty agreement.

5. In reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

Respondent reported his income on the cash receipts and disbursements basis. On this basis a loss represented by a liability is realized and is therefore deductible only when the liability is paid in cash or its equivalent. The single issue here, therefore, is whether the substitution in 1932 of respondent's new note in place of the note which he gave in 1931, constituted a payment of the original note in cash or its equivalent within the meaning of the revenue act. This issue must be decided adversely to the taxpayer on the authority of *Eckert* v. *Burnet*, 283 U. S. 140, which held that the substitution of one obligation for another, at least when the parties are the same, is not payment for tax purposes when the taxpayer is on the cash basis, regardless of its effect as between the parties.

ARGUMENT

This case does not present the question *whether* the taxpayer is entitled to a deduction. Nor does it involve the determination of whether events have occurred which under some system of accounting would form the basis of a deduction. The sole

question is *when* the deduction is allowable under the system of accounting employed by respondent.[2]

There are, in the main, two leading methods of accounting: the cash receipts and disbursements basis and the accrual basis. Section 41 of the 1932 Act, *supra*, p. 3, requires that net income shall be computed in accordance with the method of accounting regularly employed by the taxpayer. Had respondent used the accrual system, then clearly the deduction here claimed would be allowable in 1932, for on the accrual basis pecuniary obligations payable to or by the taxpayer are treated as if discharged when incurred. But respondent reported his income on the cash receipts and disbursements basis. This basis requires that he report only actual receipts and deduct only actual disbursements.

On the accrual basis, a loss represented by a liability is sustained and is therefore deductible when the liability becomes definitely ascertained (see, *e. g.*, *Burns Mfg. Co.* v. *Commissioner*, 59 F. (2d) 504 (C. C. A. 9th)); on the cash basis, on the other hand, a loss represented by a liability is sustained and is therefore deductible only when the liability is paid in cash or its equivalent. *Eckert* v. *Burnet*,

[2] It is assumed for the purpose of this case that the transaction under review has produced or will produce a deduction that is allowable at some time. However, we do not intend to concede generally that such a deduction would be allowable. It may well be that the payments ultimately made by petitioner should be classified as capital outlays rather than as expenses or losses.

283 U. S. 140; *Burnet* v. *Logan*, 283 U. S. 404, 413; *Burnet* v. *Huff*, 288 U. S. 156, 160–161; cf. *United States* v. *Mitchell*, 271 U. S. 9. Until such payment in cash or its equivalent, the loss is not realized by one on a cash basis, and the income tax law deals only with realized losses. *Lucas* v. *American Code Co.*, 280 U. S. 445, 449; *Burnet* v. *Logan, supra; Ferris* v. *Commissioner*, 38 B. T. A. 312, affirmed without opinion, 102 F. (2d) 985 (C. C. A. 2d).

The single issue here, therefore, is whether the substitution in 1932 of respondent's new note in place of the note which he gave in 1931—the new note being secured by the same collateral as that securing the original note—constituted a payment of the original note in cash or its equivalent within the meaning of the Revenue Act. This issue must be decided adversely to the taxpayer on the authority of *Eckert* v. *Burnet*, 283 U. S. 140.

In the *Eckert* case the taxpayer, who was liable to a bank as endorser of an unsecured note of an insolvent maker, took up the note during the taxable year and substituted therefor his own unsecured note. The Court held that, since the taxpayer was on the cash basis, he could not deduct the amount of the old note as a worthless debt. It pointed out that the taxpayer had made no expenditure during the taxable year of cash or of property having a cash value and consequently, on the cash basis, he realized no loss and would realize no loss until the note was paid.

Under the doctrine of the *Eckert* case, the substitution of one obligation for another, at least when the parties are the same, is not payment for tax purposes when the taxpayer is on the cash basis, regardless of its effect as between the parties. On the cash basis, neither the definite ascertainment of liability (*United States* v. *Mitchell*, 271 U. S. 9; *Burnet* v. *Huff*, 288 U. S. 156, 160; *Insurance Finance Corp.* v. *Commissioner*, 84 F. (2d) 382 (C. C. A. 3d)), nor the recognition of liability through the execution of a promise to pay (*Eckert* v. *Burnet, supra; Burnet* v. *Logan*, 283 U. S. 404, 413; *Hart* v. *Commissioner*, 54 F. (2d) 448 (C. C. A. 1st)) is sufficient to allow a deduction, for neither the existence of an obligation nor a promise to pay an obligation is a payment of cash or its equivalent within the meaning of the statute.

Respondent misconceives the nature of the rule enunciated in the *Eckert* case when he contends that the present case is distinguishable because of the Board's finding that both the taxpayer and the bank considered the execution and delivery of the new note to be a final payment of the original note (R. 15). There is no dispute that, as between the parties, the new note discharged respondent's obligation under the old note. This was also true in the *Eckert* case where the taxpayer, in return for his new note, "received the old notes, marked paid, and destroyed them" (283 U. S. at 141). But the important fact in determining whethe there has

been a loss on the cash basis is not whether an obligation has been discharged—it is rather whether the taxpayer has made any payment in cash or its equivalent to discharge it. That the substitution of a new note for an old note is not a payment in cash or its equivalent, even though it does serve to discharge the old note, is the precise holding of the *Eckert* case. See also *Hart* v. *Commissioner*, 54 F. (2d) 848, 852 (C. C. A. 1st); *Menihan* v. *Commissioner*, 79 F. (2d) 304, 306 (C. C. A. 2d).

The court below sought to distinguish *Eckert* v. *Burnet* on the ground that it related only to the "bad debt" and not to the "loss" provision of the statute (R. 40). The distinction is unsound both in fact and in principle. Examination of the briefs filed in the *Eckert* case reveals that the taxpayer there urged that he was entitled to the deduction either as a bad debt or as a business loss and that the Government contended that he was not entitled to it as either. *Eckert* v. *Burnet*, No. 351, October Term, 1930, Br. for Ptr. pp. 21–22; Br. for Resp. pp. 7–13. And this Court, after holding that the taxpayer was not entitled to a deduction for a bad debt, added (283 U. S. 141–142):

> For the purpose of a return upon a cash basis, there was no loss in 1925. As happily stated by the Board of Tax Appeals, the petitioner "merely exchanged his note under which he was primarily liable for the corporation's notes under which he was secondarily liable, without any outlay of cash or

property having a cash value." A deduction may be permissible in the taxable year in which the petitioner pays cash. The petitioner says that it was definitely ascertained in 1925 that the petitioner would sustain the losses in question. So it was, if the petitioner ultimately pays his note. So was the tax considered in *United States* v. *Mitchell*, 271 U. S. 9, 12, but it could not be deducted until it was paid.

But even were it true that *Eckert* v. *Burnet* related only to the bad debt provision of the statute, that would not alter the result since the principle enunciated is equally applicable to the loss provision. The question is one of the application of accounting principles rather than of construction of the loss or bad debt provisions. In either situation, a deduction is not recognized under the cash basis where the old note is discharged simply by the execution of a substitute note. The controlling fact in each case is that the taxpayer has not made any payment in cash by the execution of the new note and, therefore, the transaction cannot properly be reflected in a return filed on the cash basis.

Several cases in the lower federal courts and in the Board have recognized that the *Eckert* case applies to deductions for losses as well as for bad debts. *Jenkins* v. *Bitgood*, 101 F. (2d) 17 (C. C. A. 2d), certiorari denied, 307 U. S. 636; *Ferris* v. *Commissioner*, 38 B. T. A. 312, affirmed without opinion, 102 F. (2d) 985 (C. C. A. 2d); *Kuhn* v. *Commis-*

sioner, 34 B. T. A. 274. There is a statement to the contrary in the opinion of the Circuit Court of Appeals for the Ninth Circuit in *Burns Mfg. Co.* v. *Commissioner,* 59 F. (2d) 504, 507, but this was merely dictum since the taxpayer there was on the accrual basis; in any event, the court did not support its statement by any reasoning or authority and, for the reasons pointed out above, we believe it to be wrong in principle.

The other ground on which *Eckert* v. *Burnet* is sought to be distinguished is that the note there involved was unsecured while here the note was secured. It seems doubtful whether this distinction, if sound, would be available to respondent since the collateral here involved was deposited as security for the original note and was simply retained by the Bank as security for the new note; consequently, respondent did not make any real transfer of property during the taxable year, even as security.

But assuming that respondent did make such a transfer, it would not change the situation since the giving of a secured note is not payment in cash or its equivalent any more than is the giving of an unsecured note. The security makes the promise to pay more easily collectible but it does not transmute the promise itself into payment. *Jenkins* v. *Bitgood,* 101 F. (2d) 17 (C. C. A. 2d), certiorari denied, 307 U. S. 636; *Insurance Finance Corp.* v. *Commissioner,* 84 F. (2d) 382 (C. C. A. 3d); *Mel-*

linger v. *United States*, 21 F. Supp. 964 (C. Cls.); *Kuhn* v. *Commissioner*, 34 B. T. A. 274. The taxpayer remained owner of the collateral (*St. Paul Fire & M. Ins. Co.* v. *Garza County W. & M. Ass'n*, 93 F. (2d) 590, 592 (C. C. A. 5th); *Goldstein* v. *Rusch*, 56 F. (2d) 10, 11–12 (C. C. A. 2d); *Nelson* v. *Commissioner*, 101 F. (2d) 568, 571 (C. C. A. 8th); *Ball-Thrash* v. *McCormick*, 162 N. C. 471) and the Bank acquired only a possessory interest therein, with the right to sell on default in payment of the note. *City Bank Farmers' Trust Co.* v. *Bowers*, 68 F. (2d) 909, 913 (C. C. A. 2d). Clearly, therefore, the deposit of the collateral cannot be treated as the payment of cash or of property having a cash value.

Pinellas Ice & Cold Storage Co. v. *Commissioner*, 287 U. S. 462, upon which respondent relies, is not opposed to this view. The Court there simply held that when property is sold or exchanged for well-secured notes, the notes are properly regarded as the equivalent of cash rather than as securities within the intendment of the reorganization provisions of the Revenue Act.[3] But, as the Circuit Court of Appeals for the Second Circuit pointed out in *Jenkins* v. *Bitgood*, *supra*, it does not follow from this that they must be regarded as the equiva-

[3] The principle has been extended to cover long term obligations in *LeTulle* v. *Scofield*, No. 63, present Term, decided January 2, 1940. Yet if the obligor in the *LeTulle* case were on the cash basis, it could hardly be said that the obligations were paid when issued.

lent of cash when the taxpayer is the maker of the notes and the question is whether he has made a cash payment by delivery of them. The recipient of a well-secured note may at any time negotiate it and receive its value and, therefore, so far as he is concerned, the note may well be regarded as the equivalent of cash. The same is true of the holder of an unsecured note executed by an amply solvent maker. But in neither situation does the maker of the note make a cash payment until he actually liquidates his obligation and consequently, so far as he is concerned, the note cannot be regarded as the equivalent of cash.

The court below relied strongly upon *Crain* v. *Commissioner,* 75 F. (2d) 962 (C. C. A. 8th), and *Weis* v. *Commissioner,* 13 B. T. A. 1284, in support of its conclusion. Both cases are entirely distinguishable. In the *Crain* case the taxpayer and one Wesson became obligated to pay obligations of a corporation in which they were stockholders in the sum of $80,000. In 1916 Wesson paid the $80,000 in cash and took the taxpayer's note for $40,000, which the taxpayer did not pay until 1919. The court held that the loss was deductible in 1916, when the creditor was paid, and not in 1919 when the taxpayer paid the note held by Wesson. This holding was predicated upon the theory, entirely consistent with our view here, that in substance the taxpayer had borrowed $40,000 from Wesson and had paid his obligations to his creditors in cash; having made

a cash payment, he did not forfeit his deduction simply because he had acquired the cash with which to make the payment through borrowing from a third person. Similarly, in the *Weis* case, the Board held that a taxpayer who had made an investment was entitled to deduct the investment as a loss in the year in which it became worthless, even though the funds invested had been borrowed.

Under the rule of the *Crain* and *Weis* cases, the respondent here would have been entitled to a deduction if he had paid the notes to the bank in cash, despite the fact that he had borrowed the cash from a third party. But plainly it does not follow from the fact that respondent might have been able to arrange his affairs so as to make a cash payment that he is entitled to a deduction when he fails to make such a payment. Tax liability often varies according to the form which a transaction takes. For example, the taxpayer in *Eckert* v. *Burnet*, like the taxpayer here, might have borrowed money from a third party, paid his note in cash and thus have become entitled to the deduction; this possibility, however, does not affect the incidence of the tax statute upon the transaction which actually occurred. As this Court has frequently pointed out, questions of taxation are not determined by viewing what might have been done but by viewing what was done in fact. *Weiss* v. *Stearn*, 265 U. S. 242, 254; *Miles* v. *Safe Deposit Co.*, 259 U. S. 247; *United States* v. *Phellis*, 257 U. S. 156, 172;

Remington-Rand, Inc. v. *Commissioner,* 33 F. (2d) 77, 78 (C. C. A. 2d), certiorari denied, 280 U. S. 591.

Jenkins v. *Smith,* 21 F. Supp. 433 (D. Conn.), reversed on other grounds, 99 F. (2d) 827 (C. C. A. 2d), does lend support to the decision below. However, that case is of dubious authority in the light of the decisions of the Circuit Court of Appeals for the Second Circuit in *Jenkins* v. *Bitgood, supra,* and *Ferris* v. *Commissioner, supra.*

CONCLUSION

The decision below tends to impair the fundamental distinction between taxation on the cash and on the accrual bases of accounting. The decision is in conflict with both principle and authority and should therefore be reversed.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1939

No. 559.

GUY T. HELVERING, Commissioner of Internal Revenue,
PETITIONER,

v.

JULIAN PRICE.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Statement.

The petitioner, the Commissioner of Internal Revenue, has petitioned this Court for writ of certiorari to review the judgment of the Court below upon the grounds:

1. That the judgment of the Court below is in conflict with a decision of the United States Court of Appeals, Second Circuit, known as *Jenkins v. Bitgood*, 101 F. (2d) 217, and with the prior decision of this Court in *Eckert v. Burnet*, 283 U. S. 140;

2. That the judgment of the Court below obliterates the distinction between the cash and accrual bases of accounting.

Question Presented.

The question as presented in the petition for certiorari does not raise the real issue that is in this case, hence we beg leave to restate the issue as it was before the Court below, and as we believe it to be here.

The issue is not whether under the facts in the case what was done *constituted payment* of certain *notes*. The *real issue* that was before the Court below and is now presented to this Court is this:

The Board of Tax Appeals *found as a fact* that the taxpayer by *express agreement* with the North Carolina Bank & Trust Company *paid and discharged* his obligations under a *guaranty* of certain assets of another bank, and that the North Carolina Bank specifically accepted taxpayer's note and securities in *final settlement* and compromise of all further liability *under said guaranty*.

Is this Court to review this *finding of fact* (not a conclusion of law) of the Board of Tax Appeals that the taxpayer paid and discharged his obligations *under the guaranty*, merely because the *payment agreed upon* by the parties and *accepted by the Bank* was a payment made *in property* instead of in cash?

That is the real issue in this case.

Statement of the Facts.

The facts in the case were correctly found by the Board of Tax Appeals and have never been questioned. (R. 12-17.) The facts may be summarized as follows:

1. Taxpayer in September, 1929, upon a merger of certain banks, entered into a contract with North Carolina Bank & Trust Company, whereby he jointly with three other stockholders of the merged bank, agreed to guarantee certain assets of the merged bank, known as the Class A assets. In the event the guarantors were required to pay anything on account of losses in the Class A assets, they were entitled to reimbursement therefor out of certain assets known as Class B assets.

2. In June, 1931, the North Carolina Bank advised the guarantors that their guaranty was not in such shape that the Bank could use it, and accordingly requested the guarantors to put their guaranty into a bankable form so it could be used by the Bank to obtain credit. Taxpayer agreed, and accordingly executed and delivered to the Bank a note for $125,000 and endorsed the note of C. W. Gold, another guarantor, for a like amount, and assigned certain securities to the Bank as security for the payment of his guaranty. In consideration of his putting his guaranty into such bankable form the Bank agreed that the taxpayers' ultimate liability under his guaranty should not exceed $250,000.

3. "At the end of 1931 the *guaranty agreement was still in force and effect.* The 'B' assets were still in the hands of the North Carolina Bank as trustee and were still in the process of collection. No demand had ever been made upon the petitioner (taxpayer) for the payment of any part of his obligation under the guaranty. While it was known that there would be some loss to the guarantors, it was not definitely known throughout 1931 what the loss would be, and the guarantors had every reason to believe that there would be a substantial reimbursement from the Class B

assets of any losses." (Findings of Fact, Board of Tax Appeals) (R. 14-15.)

4. In the early part of 1932 financial conditions in Greensboro took a turn for the worse, and collections on the A and B assets declined to a point where the Bank realized that it would have to collect upon the *guaranty*. Accordingly in March, 1932 the North Carolina Bank called upon taxpayer to make a *final settlement* of his obligations under the *guaranty*. (R. 15.)

5. The taxpayer thereupon offered to make a final settlement of his obligations under the guaranty by giving the Bank his note for $250,000, and assigning to the Bank certain securities which the Bank held. The Bank *accepted the taxpayer's offer*, and upon receipt of the taxpayer's note and the assignment of the securities which it already held, considered that the *guaranty obligations were fully discharged*, and accordingly delivered to taxpayer the two notes which had been executed under the guaranty agreement and marked them paid. Both the taxpayer and the Bank considered this to be *final payment* and *settlement* of taxpayer's *obligations under the guaranty*. (R. 15.)

6. The taxpayer claimed a loss on the transaction in his return for 1932 in the amount of $125,000, being his own half of the guaranty for which he had no possibility of reimbursement. He did not claim a loss on Gold's half of the guaranty in 1932 because he still had a claim against Gold's Estate for reimbursement. In his return for 1933 taxpayer claimed a loss for the remaining half, representing Mr. Gold's part of the guaranty, when it was ascertained that Gold's estate was insolvent in 1933. (R. 16.)

The Commissioner allowed the loss claimed for 1933, when it first appeared that Gold's Estate was insolvent and that taxpayer would receive no reimbursement for the loss sustained on that part of the guaranty. He disallowed the loss claimed for 1932 upon the ground that the taxpayer had not paid cash in that year. But the loss for both years arose out of precisely the same transaction. (R. 35.)

Summary of Argument.

Point 1. The decision of the Court below is not in conflict with *Eckert v. Burnet*, or *Jenkins v. Bitgood*, or with any other case cited by the Commissioner.

The decision here is in harmony with the clearly expressed opinion of this Court as to the correct construction of *Eckert v. Burnet* which is found in *Burnet v. Logan*, 283 U. S. 404.

The decision here is in harmony with the decision of the Circuit Court of Appeals for the Eighth Circuit in *Crain, Exec., et al. v. Commissioner*, 75 F. (2d) 962, a decision published by the Commissioner as a Treasury Decision in Cumulative Bulletin XIV-2, 281.

It is in harmony with *Jenkins v. Smith*, 21 F. Supp. 433, affirmed (C. C. A. 2) in 99 F. (2d) 827.

Point 2. The decision of the Court below that the payment and discharge of a legal obligation is not required to be *in cash*, but may consist of the giving and acceptance of *other property* agreed upon by the parties—has been recognized by this Court for over one hundred years. See *Lyman v. Bank*, 53 U. S. 225; *Segrist v. Crabtree*, 131 U. S. 287; *Case Manufacturing Co. v. Soxman*, 138 U. S. 431.

This principle has been followed by the Federal courts and by the Board of Tax Appeals in many tax cases, both as to items of income and as to items of deductions. *Schlemmer v. United States*, 94 F. (2d) 77, and cases there cited.

This Court has held specifically that the giving and acceptance of fully secured promissory notes may *constitute payment* of a legal obligation, and that such notes are the *equivalent of cash* for income tax purposes. *Pinellas Ice and Cold Storage Co. v. Commissioner*, 287 U. S. 462, 77 L. ed. 428.

Point 3. The decision of the Court below has nothing whatever to do with obliterating the distinction between the cash basis and the accrual basis of accounting.

ARGUMENT.

Point 1.

The decision of the Court below is not in conflict with Eckert v. Burnet, or Jenkins v. Bitgood, or with any other case cited by the Commissioner.

There are at least six respects in which *Eckert v. Burnet* is distinguishable:

1. In the first place, the *Eckert* case involved the question of a *bad debt*. In the instant case the taxpayer claims the deduction as a *loss* arising from a contract of guaranty. The two types of deductions are provided for under different provisions of the revenue act, and the rules applicable to the two types are by no means the same. A bad debt is deductible in the year it is ascertained by the taxpayer to be worthless. On

the other hand a loss is deductible in the year it is sustained or realized, due to the happening of definite or identifiable events.

The *Eckert* case has been expressly distinguished upon this ground in several cases, the leading case being *Burns Mfg. Co. v. Commissioner*, 59 F. (2d) 504, where the Circuit Court of Appeals, Ninth Circuit, analyzed the *Eckert* case at length and then said, p. 507:

> "In the *Eckert case* the Supreme Court considered merely the effect of section 214(a) 7, 26 U. S. C. A. Sec. 955 (a) (7), which provides for deduction for '*debts ascertained to be worthless* and charged off within the taxable year.' The amount here under consideration was a '*loss*' and *not a 'bad debt'* and consequently the *decision in the Eckert case is not controlling.*" (Italics ours.)

Indeed, the headnote and syllabus of *Eckert v. Burnet* exemplifies the point actually decided in that case too plainly for misunderstanding. It reads as follows:

> "One making his income tax returns on the cash basis, who has given his own note in exchange for worthless notes on which he was an endorser, cannot deduct from the gross income of the year in which he so gave his own note the amount thereof, *as a debt* 'ascertained to be worthless and charged off within the taxable year,' under the Revenue Act of 1926, c. 27, sec. 214(a)(7), etc."

That was the basis of this Court's decision in *Eckert v. Burnet*. No question as to a *loss* was decided in *Eckert v. Burnet*, and Sec. 214(5) (the provision as to losses) was not even mentioned.

There is certain language in the latter part of the *Eckert v. Burnet* opinion which uses the word "loss" somewhat ambiguously, but it is obvious that such language did not apply to the *loss provisions* of the revenue act of 1926 (Sec. 214(5)). It follows that such language of this Court would be *dictum* if it were to be applied to a *claim for a loss—i. e.*, a claim arising under a section of the revenue act which was not before this Court in *Eckert v. Burnet*.

Precisely this construction of *Eckert v. Burnet* is made by Judge Learned Hand in *Shiman v. Commissioner*, 60 F. (2d) 65, where it is said:

> "We can see no ground therefore for question except some of the language used in Eckert v. Burnet, 283 U. S. 140, 51 S. Ct. 373, 75 L. Ed. 911, taken from our opinion in 42 F. (2d) 158. That was quite another situation. Eckert, the taxpayer, had been an accommodation endorser for a corporation which became insolvent. When called upon to *pay* he gave his note *instead*, not payable within the year. The court refused to allow the deduction, because Eckert was keeping his books on a cash basis, but it intimated that when he paid he might succeed; until then he had done no more than change the form of the obligation. Yet if it were enough to defeat him that the debt was 'worthless when acquired,' *the same objection ought to be good after he had paid; contrary to what was suggested. We cannot therefore think that the language so thrown out was intended as an authoritative statement by which we must be bound.*" (Italics ours.)

2. In the second place, there was *no agreement* whatever between Eckert and the bank that Eckert's note should be accepted by the bank as a *final payment or discharge*

of the corporation's note. As Judge Hand put it: "When called upon to *pay* he gave his note *instead.*"

In the instant case it was *expressly* agreed between Mr. Price and the North Carolina Bank that the note and securities given by Mr. Price should *pay and discharge* any further obligations of Mr. Price under his guaranty. (R. 15 and 19.)

3. In the third place, the issue in the two cases was entirely different. The issue in the *Eckert* case was whether upon all the evidence in that case the Board could decide *as a conclusion of law* that what was done *constituted payment*, or not.

But in the instant case the Commissioner conceded and the Board found *as a fact* upon the testimony that Mr. Price's obligations under the guaranty were *paid and discharged* and that the Bank accepted Price's note and security in a *final settlement and compromise* of all further liability under the guaranty. (R. 15, 19; Deposition Price, pp. 23, 24, 37.)

The question as to *what constitutes payment* was never an issue in this case.

4. In the fourth place, in the *Eckert* case there was no transfer or assignment of securities or other property by Eckert to the bank.

In the instant case Mr. Price assigned securities to the Bank admitted by the Commissioner to be worth in excess of $250,000, and which Price could never get back without substituting other property of equal value therefor.

5. In the fifth place, in the *Eckert* case there was no other property (corresponding to the Class B. assets in the instant case) to which Eckert could look for reimbursement, and which also became worthless during the taxable year as was the case here. ((R. 13-15.)

6. And, finally, in the *Eckert* case the claim for a *bad debt* in question arose out of Eckert's endorsement of a *note*.

In the instant case, however, the *loss* claimed by Mr. Price arose out of his independent *contract of guaranty* of certain real estate and other Class A assets of a closed bank, liability for which became fixed and determined for the first time in 1932 when the losses occurred in those assets.

In short, *Eckert v. Burnet* is not in conflict with the instant case at all—either in principle or in fact.

The Court below did *not* consider *Eckert v. Burnet* as conflicting. The Court did discuss the *Eckert* case, but carefully distinguished that case *upon its facts*, and then pointed out that the issue there was entirely different, saying in part:

> "We consider this case (Eckert v. Burnet) as definite authority only for the holding that a loss of the character set forth is not deductible under the '*bad debt*' provision of the statute (Burns Mfg. Co. v. Commissioner, 9 Cir. 59 F. 2d 504, 507), although the language does indeed go further and lay down the proposition that where there is a mere deferring of a loss by the renewing of an obligation, the loss may not be deducted until the obligation is paid, *a proposition which we are not disposed to question*. That it was not intended to prevent by that decision the taking

> of a loss in a case such as this, where the loss is evidenced by a closed transaction, but merely to prevent the taking of a supposed loss which has never been realized, is indicated by the decision in *Burnet v. Logan*, 283 U. S. 404, 413, where the court refers to the Eckert decision as follows: '*Ordinarily*, at least, a taxpayer may not deduct from gross receipts a supposed loss which in fact is represented by his outstanding note. Eckert v. Commissioner of Interual Revenue, *ante*, p. 140. And, conversely, a promise to pay indeterminate sums of money is not necessarily taxable income.' "Generally speaking, the income tax law is concerned only with realized losses, as with realized gains." ' "

In fine, the decision of the Court below is based wholly *upon the facts* in the instant case. The Court rests its decision squarely upon the agreement between Mr. Price and the North Carolina Bank by which Price's obligation (as well as Gold's) under the guaranty was finally compromised and settled. The Court below called this agreement the "crucial matter" of the case and quoted in full the finding of the Board of Tax Appeals on that point as its *firmum decisis*. (R. 34.)

* * * * *

As to the case of *Jenkins v. Bitgood* less need be said. The facts are utterly different from start to finish from those in the instant case, and the issue in neither the District Court nor in the Circuit Court of Appeals was the same as the issue is here.

In *Jenkins v. Bitgood* taxpayer was director of a bank which owned certain bonds that had depreciated in value. to make up this depreciation the directors in 1931 agreed

to purchase from the bank these bonds at their original cost price to the bank. Jenkins therefore purchased bonds having a face value of $25,000 (but a market value of only $5,550) and gave his promissory note to the bank which delivered to him the bonds.

In 1932 the bank failed and its stock became worthless. Jenkins claimed a loss *on the bonds* so purchased by him of $19,450, being the difference between the amount he had paid for them, to wit, $25,000, and the market value of such bonds.

The District Court held that the 1931 transaction was a purchase of the bonds from the bank by the taxpayer, that "the $25,000 was undoubtedly an investment in bonds", and that, since the bonds had not been disposed of during the taxable year, there was "nothing upon which to predicate a deductible loss in 1932." (21 F. Supp., p. 250.) The decision of the District Judge upon rehearing was that "the substance of the transaction was a purchase and sale of securities", to wit, bonds, and the former opinion was reaffirmed (22 F. Supp. 16).

Jenkins appealed to the Circuit Court of Appeals and contended that the purchase of the bonds in 1931 in effect represented an additional cost of his stock in the bank. The Commissioner did not contest that argument, but denied the loss. The Circuit Court of Appeals therefore *assumed* that it was a contribution to capital, and then—after admitting that no authority on the question had been found—proceeded to hold that a taxpayer *can not make an expenditure increasing the cost of his stock in a business enterprise by the giving of a note.* The Court went further and said that the taxpayer's additional cost will not be "made" until the taxpayer pays the note which he gave in 1931.

Aside from the doubtfulness of the Circuit Court's decision that a taxpayer can not increase the cost of an investment in stock by the giving of a note, it seems perfectly clear that the issue in *Jenkins v. Bitgood* involved a wholly different question of law than the issue in the instant case. For example:

1. *Jenkins v. Bitgood* was decided by the District Court on the issue of the taxpayer's *purchase of bonds* which had not been disposed of during the taxable year, and hence no loss was deductible.

On the other hand, the case was decided by the Circuit Court of Appeals upon the issue of whether or not the 1931 transaction amounted to a contribution to capital. Neither of those two issues of law is involved in this case.

2. In the second place, the opinion of the Circuit Court is devoted to the consideration of an issue which was not contested by the Commissioner, *i. e.*, that the 1931 transaction was a contribution to capital. That, however, was not the issue upon which the case was decided by the lower court, and hence the principal part of the Circuit Court of Appeals' opinion was moot, being based upon a conceded issue.

3. In the third place, the statement of the Circuit Court that Jenkins could "make" no investment in the bonds which he purchased because he paid for them by giving a note instead of cash, is patently erroneous. The effect of such a decision would lead to absurd results. If a taxpayer can not deduct a loss on worthless stock or bonds merely because he has not paid *all the purchase price in cash*, then the whole business world will be revolutionized. Every stockholder in the nation will hold stock at his peril unless he pays for it in full and in cash. If a man's automobile is destroyed

by fire or collision, he can not claim the loss merely because his purchase money note is still in the hands of a finance company.

* * * * *

The case of *Ferris v. Commissioner* referred to in the petition for writ of certiorari, was a decision of the Board of Tax Appeals which was affirmed *per curiam* without opinion by the Circuit Court of Appeals, Second Circuit: We do not know the reasons why the Circuit Court affirmed the Board. The opinion referred to *Eckert v. Burnet*, but the facts in the *Ferris* case were quite different from those in the *Eckert* case.

The *Ferris* case involved the giving of a check by the taxpayer; the *Eckert* case arose out of a note given in substitution for another note. In the *Eckert* case there was no agreement whatever between the parties that what was done there should constitute payment and discharge of the prior note; in the *Ferris* case there was a presumptive payment arising from the giving and acceptance of the check. In the *Eckert* case there was no negotiation for a loan of funds, nor was there any actual borrowing of money by Eckert; in the *Ferris* case Mr. Ferris negotiated with the bank for a loan of funds and obtained sufficient funds to pay the debt.

More than that, however, it is difficult to see any conflict between the *Ferris* case and *Eckert v. Burnet* for the obvious reason that the issue in *Eckert v. Burnet* was one of a *bad debt*, while the issue in the *Ferris* case was one of a *loss*. It seems quite doubtful, therefore, whether *Eckert v. Burnet* was any more authority for the decision in *Ferris* case, than it is authority for this case.

* * * * *

The decision of the Court below is entirely in line with several decisions of long standing in which the Commissioner has long acquiesced, and which in fact the Commissioner has cited and relied upon in other tax cases.

One of the leading cases is *Crain, et al. v. Commissioner*, 75 F. (2d) 962, published by the Commissioner as a Treasury Decision in C. B. XIV—2, p. 281. The facts in that case are quite analogous and deserve a brief review. In the *Crain* case the taxpayer with one Wesson became liable upon the obligations of National Car Advertising Company, which they jointly assumed. In 1913 it was evident that there would be a loss, but the amount of the loss was still uncertain. In 1916 it became definitely known what the amount of the loss was, and that taxpayer and Wesson were jointly and severally liable for the full amount of the loss. By a general agreement between the parties it was agreed that Wesson should take care of the corporation's obligations, and that taxpayer would give Wesson his note for one-half thereof. Taxpayer claimed the loss in a later year. Said the Court:

> "But in the year 1916, the amount of *loss became definitely certain*, and the whole of it was actually paid by Wesson. Since the taxpayer did not himself have on hand enough cash to pay his half, he agreed with Wesson that the latter should *advance all of the money in payment of the loss*, and the *taxpayer would make to Wesson a note for the taxpayer's half of such loss.*
>
> "*In fair effect, what the taxpayer did in 1916 was to borrow $40,000* in money with which to pay the loss now, here in dispute, as to the date of its accrual for taxing purposes. It seems clear, from the facts here and the ruled cases, that the loss occurred in 1916. Avery v. Commissioner (C. C. A.), 22 F. (2d) 6, 55 A. L. R. 1277; Darling v. Commissioner (C. C. A.), 49

F. (2d) 111. Did the giving of the note to Wesson have the effect to lawfully postpone deduction of the loss from income till the year in which the note was paid?

"The taxpayer contends that it did, and, so contending, relies largely on the case of Eckert v. Commissioner, 283 U. S. 140, 51 S. Ct. 373, 374, 75 L. Ed. 911, as decisive in his favor. * * *" (Italics ours.)

The Court in this opinion distinguishes the *Crain* case from the *Eckert* case and holds that the deductible loss occurred in 1916. The Court then says:

"Moreover, counsel agree, and the decisions of the Board of Tax Appeals sustain their agreement, that the fact that *a loss is paid in borrowed money does not have the effect to change the date at which the loss was sustained from the year of the loss to the year in which the borrowed money was repaid.*" (Italics ours.)

* * * * *

"To the same effect are the cases of Weis v. Commissioner, 13 B. T. A. 1284; Crawford v. Commissioner, 11 B. T. A. 1299; and Perry v. Commissioner, 28 B. T. A. 497."

Also in line with the decision here is the case of *Jenkins, et al. v. Smith*, 21 F. Supp. 433, affirmed 99 F. (2d) 827. In that case the taxpayer in order to protect his stock in a bank, made a guaranty agreement in 1932 jointly with other directors and deposited certain collateral. In 1933 the bank ceased doing business and called on the guarantors for payment under their guaranty. Taxpayer thereupon made arrangements with the bank to borrow upon his note the same amount of money for which he was liable to the bank, and to apply the same to the payment of his

guaranty obligations. This was done and accordingly taxpayer claimed a loss in his return for 1933. Said the Court:

"The deduction was proper and plaintiffs must prevail if, under all the circumstances, the *obligation on the bond was paid.* The defendant urges, however, that there was no payment in fact, but only in form, since the decedent remained obligated to the First National Bank and Trust Company for the same amount, evidenced by a new note. He parted with no cash in 1933, but merely borrowed from his payee in order to pay the same payee.

"In my opinion, *the obligation on the bond* was discharged by the acceptance by the First National of the check as payment. *Where or how the decedent obtained the money with which to make the check good is immaterial.* The acceptance of the check as payment discharged the obligation, even though it created an overdraft. A new cause of action arose upon the check. The First National could no longer have sued the decedent on the bond. The bank knew of the overdraft, but was satisfied to take its chances on the new obligation. *The bond transaction was closed.*

"The credit to the decedent's account, made on the same day, was the result of a new transaction, initiated by a promissory note to the bank secured by new collateral. It was in no sense an extension of time for payment of the old debt. It was *a new contract of a substantially different nature.*" (Italics ours.)

Point 2.

The decision of the Court below that the payment and discharge of a legal obligation may be made by the giving and acceptance of property other than cash, is in accord with the decisions of this Court for over one hundred years.

Lyman v. Bank, 53 U. S. 225; *Segrist v. Crabtree*, 131 U. S. 287; *Case Manufacturing Co. v. Soxman*, 138 U. S. 431.

That principle of law has been recognized by the Federal courts in many recent tax cases, as applied to both questions of *income* and questions of *deductions* from income. *Schlemmer v. United States*, 94 F. (2d) 77 (2d. Cir.); *George J. Mellinger v. United States* (Ct. Cl.) 21 F. Supp. 964; *Humphrey v. Commissioner*, 91 F. (2d) 155 (9th Cir.); *Jenkins v. Smith*, 21 F. S. 433, aff'd 99 F. (2d) 827 (2d Cir.); *Bedell v. Commissioner*, 30 F. (2d) 622 (2d Cir.).

This Court has recognized in tax cases that an obligation may be paid and discharged for income tax purposes by the giving and acceptance of fully secured notes, and that such notes shall be treated as the "equivalent of cash". *Pinellas Ice & Cold Storage Co. v. Commissioner*, 287 U. S. 462.

The decision of the Court below that the payment of a legal obligation need not be made in cash for income tax purposes has been recognized by the Commissioner's own regulations for over twenty years. Ever since Regulations 45, promulgated under the Revenue Act of 1918, and continuing through successive Regulations promulgated under the revenue acts thereafter, the Commissioner has ruled as follows:

"Items of *income* and of *expenditures*, which as gross income and *deductions* are elements in the computation of net income *need not be in the form of cash.* It is sufficient that such items, if otherwise properly included in computation, *can be valued in terms of money.*" (Art. 321, *Regulations 77* and *74*; Art. 22, *Regulations 69, 65, 62* and *45.*)

The leading text writers on income taxation have always recognized this principle. In *Holmes "Federal Taxes,"* Sec. 471, the rule is stated as follows:

"It is not necessary that an amount claimed as a deduction be paid out in cash. Just as income may be received in kind or in the equivalent of cash, so *deductions may be represented by payments* in some form other than actual cash."

In *Paul & Mertens "Law of Federal Income Taxation"*, we find this:

"* * * the term 'cash method' is a misnomer. * * * It does not mean that *only* cash receipts are taxable, any more than it means that *all* cash receipts are taxable. The thought is rather that *both taxable income and items of expenditure need not be in the form of cash.*" (Sec. 10.01) citing 46 *Harvard Law Review* 933.

"Many of the decisions turn on the question of *security;* they regard as the equivalent of cash obligations which are in some way—by lien, mortgage or otherwise—*secured.* Often this question is valid because relevant to the point of *convertibility into cash.* * * * The real question is whether *cash can be realized;* has the equivalent of cash been received." (Sec. 10.05) Citing *Bedell v. Commissioner*, 30 F. (2d) 622; *S. L. Meyer*, 23 B. T. A. 1200.

"Bonds, notes and contracts for the payment of money and other property are the equivalent of cash if, received on an income-producing transaction, to the extent of their fair market value * * *" (Sec. 10.16). Citing *Brinkerhoff-Faris Trust Co.*, 14 B. T. A. 801.

"This whole subject of the extent to which notes should be treated as the equivalent of cash is still in a state of uncertainty. The *general rule is clear that notes may be treated as the equivalent of cash;* * *" (Sec. 10.16). Citing *Pinellas Ice & Cold Storage Co. v. Commissioner*, 287 U. S. 462.

Roswell Magill, former Undersecretary of the Treasury, in the *Harvard Law Review*, Vol. 46, p. 936, states the principle as follows:

"A concession is necessary, at the outset, because the bulk of claims are not actually liquidated in cash; salaries, dividends, rent, interest, are commonly paid by check. * * *Negotiable *notes have been treated as cash to the extent of their fair market value,* but a non-negotiable note has been regarded as giving rise to income only as collected." Citing *Lyle v. Olson*, 24 B. T. A. 702; *A. W. Wolfson*, 1 B. T. A. 538; *Potter Farms, Inc.*, 6 B. T. A. 110; *C. W. Slater*, 5 B. T. A. 804; *Mainard E. Crosby*, 14 B. T. A. 980.

Payment is the test of whether a given item constitutes either income or a deduction to a taxpayer. As stated by *Paul & Mertens*, Sec. 11.21:

"*The corollary of the rule stated in regard to income is true with respect to deductions.* Taxpayers on a cash basis may not take advantage of a liability to pay; they have no right to a deduction until they make payment."

"The *rule* that deductibility in the case of taxpayers on a cash basis *depends on payment* introduces the question of *what constitutes payment.*".

The decision of the Court below is based squarely on the facts in this case: to wit—(1) that by express agreement with the North Carolina Bank taxpayer paid and discharged his obligations under the guaranty and that the Bank accepted taxpayer's note and security in final settlement and compromise of all further liability thereunder; and (2) that the taxpayer's note was fully secured and was the equivalent of cash; and (3) that the taxpayer thereby parted with money or money's worth, which is all the statute requires.

Point 3.

The decision of the Court below has nothing whatever to do with obliterating the distinction between the cash basis and the accrual basis of accounting.

As already pointed out, the decision of the Court below is based entirely upon the peculiar facts in this case. The decision of the Court accepts *as a fact* the finding of the Board of Tax Appeals that the taxpayer's note was fully secured by the irrevocable assignment of securities to the Bank, that the parties settled and compromised taxpayer's obligations under the guaranty, and that the Bank accepted the taxpayer's note and security as a final payment of any further liability thereunder.

To a taxpayer on a cash basis the test of deductibility of an item of loss or expense, as well as the test of inclusion of

an item of income, has always been *payment*. Where payment has been conceded as a fact by the Commissioner and found as a fact by the Board, no issue of law as to *payment* can possibly arise. The very *fact of payment* itself complies with all the requirements of the cash basis—hence we fail to see how the decision below could possibly effect, or change, or modify the principles of taxation which apply to the cash basis of accounting. In short, the taxpayer did all that the cash basis requires to entitle him to the deduction—he paid and discharged his obligations to the Bank under his old guaranty. That is all that the cash basis implies, and that is all the law requires.

We respectfully submit that there is no conflict whatever in principle between this case and the cases cited by the Commissioner, and that the application for the writ of certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. 559.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,
v.
JULIAN PRICE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF FOR THE RESPONDENT.

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IN THE

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OCTOBER TERM, 1939.

No. 559.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,
v.
JULIAN PRICE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF FOR THE RESPONDENT.

Opinions Below.

The memorandum opinion of the United States Board of Tax Appeals (R. 11-19) is not reported. The opinion of the Circuit Court of Appeals (R. 32-41) is reported in 106 F. (2d) 336.

Question Presented.

We can not agree that the Commissioner's brief correctly states the question before this Court. Actually there are two issues presented in this case.

The *first issue* is this: Will this Court undertake to review a *finding of fact* (not a conclusion of law) of the Board of Tax Appeals based upon evidence of record which was found sufficient by the Board, was undisturbed by the Circuit Court of Appeals, and which even the Commissioner does not now dispute as a fact—to wit, *Payment*.

The question as to whether or not the transaction here "constituted a payment of the original note", as stated in the Commissioner's brief, page 9, is *not* now an issue in this case. Payment was found as a *fact* by the Board of Tax Appeals. It was not a conclusion of law drawn as an inference or as a legal deduction from other facts. Payment was found *as a fact* by the Board, because the witnesses testified that the parties had expressly agreed upon a payment.

The *second issue* before this Court is this. *Payment* of the taxpayer's obligation under his guaranty contract with the Bank being conceded as a fact by the Commissioner (Brief, pp. 7, 12)—is the taxpayer here to be denied the loss which the Commissioner concedes has occurred (Brief, p. 10) merely because the payment agreed upon by the parties and accepted by the Bank was not made in the form of cash?

Statute and Regulations Involved.

Sec. 23(e), Revenue Act of 1932, c. 209, 47 Stat. 169:

> (e) *Losses by Individuals.*—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business;

* * * * *

Regulations 77, Art. 321:

Items of *income* and of *expenditures* which as gross income and *deductions* are elements in the computation of net income *need not be in the form of cash.* It is sufficient that such items, if otherwise properly included in computation, *can be valued in terms of money* (Emphasis supplied.)

Statement of Facts.

The facts in the case were correctly found by the Board of Tax Appeals and have never been questioned. (R. 12-17.) The facts may be summarized as follows:

1. The taxpayer is a resident of Greensboro, North Carolina. During the year 1929 he was president and a substantial stockholder of the Jefferson Standard Life Insurance Company, which company was a large stockholder and depositor in the Atlantic Bank and Trust Company of Greensboro. The taxpayer himself was also a stockholder of the Atlantic Bank. (R. 12.)

2. In September, 1929, the Atlantic Bank was merged with several banks and trust companies under the name of North Carlonia Bank and Trust Company. Under the plan of merger certain assets of the Atlantic Bank, called "A" assets, were accepted conditionally by the North Carolina Bank and certain other assets, called "B" assets, were pledged to that bank with authority to charge against the "B" assets any losses which might be established in real-

izing upon the "A" assets. As part of the merger the taxpayer and three other stockholders of the Atlantic Bank executed a guaranty agreement to the effect that, if the North Carolina Bank failed to realize a certain sum from the "A" assets within two years, they would make up the deficiency in an amount not exceeding $500,000. The agreement provided that any sums realized from the "B" assets were to be applied first to any losses occurring in the "A" assets and then to reimbursement of the four guarantors. The period for realizing upon the "A" assets under the terms of the guaranty was subsequently extended with the consent of the guarantors for an additional year, or until September, 1932. (R. 12-13.)

3. In June, 1931, the North Carolina Bank advised the guarantors that their guaranty was not in such shape that the Bank could use it, and accordingly requested the guarantors to put their guaranty into a bankable form so it could be used by the Bank to obtain credit. Taxpayer agreed, and accordingly executed and delivered to the Bank a note for $125,000 and endorsed the note of C. W. Gold, another guarantor, for a like amount, and assigned certain securities to the Bank as security for the payment of his guaranty. In consideration of the taxpayer's doing these things, the Bank agreed that the taxpayer's ultimate liability under his guarantey should not exceed $250,000.

4. "At the end of 1931 the *Guaranty agreement was still in force and effect.* The 'B' assets were still in the hands of the North Carolina Bank as trustee and were still in the process of collection. No demand had ever been made upon the petitioner (taxpayer) for the payment of any part of his obligation under the guaranty. While it was known that there would be some loss to the guarantors, it was not

definitely known throughout 1931 what the loss would be, and the guarantors had every reason to believe that there would be a substantial reimbursement from the Class B assets of any losses." (Findings of Fact, Board of Tax Appeals) (R. 14-15).

5. In the early part of 1932 financial conditions in Greensboro took a turn for the worse, and collections on the A and B assets declined to a point where the Bank realized that it would have to collect upon the *guaranty*. Accordingly in March, 1932, the North Carolina Bank called upon taxpayer to make a *final settlement* of his obligations under the *guaranty* (R. 15).

6. The taxpayer thereupon offered to make a final settlement and pay his obligations under the guaranty by giving the Bank his note for $250,000, and assigning to the Bank certain securities which the Bank held. The Bank *accepted the taxpayer's offer*, and upon receipt of the taxpayer's note and the assignment of the securities which it already held, considered that the *guaranty obligations were fully discharged*, and accordingly delivered to taxpayer the two notes which had been executed under the guaranty agreement and marked them paid. Both the taxpayer and the Bank considered this to be *final payment* and settlement of taxpayer's *obligations under the guaranty*. (R. 15.)

7. In December, 1932, the taxpayer advised the North Carolina Bank & Trust Company that he desired to withdraw the securities of his wife and to deposit a like amount of his own securities. This request was granted and in that month taxpayer assigned to the Bank the same amount of Jefferson-Standard stock which he owned.

8. The taxpayer claimed a loss on the transaction in his return for 1932 in the amount of $125,000, being his own half of the guaranty for which he had no possibility of reimbursement. He did not claim a loss on Gold's half of the guaranty in 1932 because he still had a claim against Gold's Estate for reimbursement. In his return for 1933 taxpayer claimed a loss for the remaining half, representing Mr. Gold's part of the guaranty, when it was ascertained that Gold's Estate was insolvent in 1933. (R. 16.)

9. The Commissioner allowed the loss claimed for 1933, when it first appeared that Gold's Estate was insolvent and that taxpayer would receive no reimbursement for the loss sustained on that part of the guaranty. He disallowed the loss claimed for 1932 upon the ground that the taxpayer had not paid cash in that year. But the loss for both years arose out of precisely the same transaction. (R. 35.)

Summary of Argument.

The Commissioner bases his argument in the final analysis almost wholly upon the decision of this Court in *Eckert v. Burnet* (1931), 283 U. S. 140. We desire, therefore, first to point out in this brief three things in connection with that case, as follows:

Point 1—That Eckert v. Burnet, arose out of an entirely different state of facts, and is distinguishable upon its facts.

Point 2—That Eckert v. Burnet, did not involve the same issue of law as was involved in the instant case.

Point 3—That even if the rule in Eckert v. Burnet, is applied to this case the taxpayer is still entitled to the deduction in question.

ARGUMENT.

The Commissioner in effect concedes on brief that the taxpayer suffered the loss in question, and that if the taxpayer has been on the accrual basis, "the deduction here claimed would be allowable in 1932". (Br. pp. 9-10). The only question raised by the Commissioner is *when* the loss is deductible.[1] The Commissioner contends that the loss was not deductible in 1932 because the loss was not paid in cash during that year. The Commissioner cites *Eckert v. Burnet* as the only authority from this Court on the subject.

POINT 1.

Eckert v. Burnet arose out of an entirely different state of facts, and is distinguishable upon its facts from the case at bar.

(1) In the first place, in *Eckert v. Burnet* there was no agreement whatever between Eckert and the bank that Eckert's note should be accepted by the bank in settlement and final payment of the Corporation's note. Eckert simply renewed or extended an already existing obligation with no understanding that it was a payment of any sort. As Judge L. Hand said of the *Eckert case* in *Shiman v. Commissioner*, 60 F. (2d) 65: "When called upon to *pay* he gave his note *instead*." (Emphasis supplied.)

In the instant case it was expressly agreed between Mr. Price and the North Carolina Bank and Trust Company

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[1] In a footnote the Commissioner suggests some speculation about the loss in question being treated possibly as a "capital outlay". That speculation is quite inconsistent with the Commissioner's statement found on p. 10 that "Had Respondent used the accrual system then clearly the deduction here claimed would be allowable in 1932, for on the accrual basis pecuniary obligations • • • are treated as discharged when incurred." Surely the fact as to a loss occurring would be the same on either basis—regardless of its deductibility.

that the note and securities given by Mr. Price should be accepted "in final settlement" and "as a final payment" of his obligations under the guaranty. (R. 15.)

(2) In the second place, in *Eckert v. Burnet*, Mr. Eckert's original obligation was simply that of an endorser upon a note. His liability upon that note was a limited one restricted by the terms of the note and by the conditions as to due presentment for payment at maturity, notice, demand and protest, and subject to all the various principles governing the relationship of accommodation endorsers under the law of negotiable instruments. If the bank had omitted or failed to comply with any of the technical requirements as to such endorsements, Eckert as endorser might have been ultimately relieved of his liability on said note or any extension thereof.

But in the instant case Mr. Price's obligations were incurred through a contract of indemnity under which he incurred certain contingent liabilities and acquired certain contingent assets. When those assets became worthless he was called upon not to *renew* his liability, but to *pay* it. And he did *pay* it.

(3) In the third place, in the *Eckert case* there was no assignment or transfer of securities or other property by Eckert to the bank.

But in the instant case Mr. Price assigned and transferred securities to the Bank admitted by the Commissioner to be worth in excess of $250,000 (R. 8), and which securities Mr. Price could never recover without giving up other property of equal value therefor.

Mr. Price's economic loss occurred when he parted with those securities in 1932 as part of the terms and conditions of his payment. It was *then* that his estate was diminished —*not* in a later year when he merely exchanges one asset for another by giving cash *in consideration for the return* of the securities.

(4) In the fourth place, in the *Eckert case* there was no other property to which Eckert could look for reimbursement.

But in the instant case there were valuable assets, known as the Class B assets, in which Mr. Price had an interest and to which he could look for reimbursement of any loss he was compelled to pay under his guaranty. Those assets also became worthless in 1932.

POINT 2.

Eckert v. Burnet did not involve the same issues of law as are involved in the instant case.

(1) The real issue before the Court in *Eckert v. Burnet* arose out of Eckert's claim that he could deduct the old note of the Electric Refrigerator Company as a *bad debt*. As Justice Holmes stated in that case (p. 140): "The petitioner claimed a deduction from income of $22,400 as a bad debt." And again on page 141, "The petitioner claims the right to deduct that sum as a *debt* 'ascertained to be worthless and charged off within the taxable year.'" (Emphasis supplied.)

That was the issue upon which Justice Holmes decided *Eckert v. Burnet*. Said Justice Holmes (p. 141):

"It seems to us that the circuit court of appeals sufficiently answered this contention by remarking that the *debt was worthless when acquired.* There was nothing to charge off. The *petitioner treats the case as one of an investment that later turns out to be bad.*" (Emphasis supplied.)

In other words, *Eckert v. Burnet* decided an issue of a *bad debt* under Sec. 214(a)(7), Revenue Act of 1926. It did not decide an issue of a loss under Sec. *214(5)*. Sec. *214(5)* (the loss provision) was not before this Court in *Eckert v. Burnet*. See Burns Mfg. Co. v. Com., 59 F. (2) 504; Dexter v. Com., 99 F. (2) 769.

What is said in *Eckert v. Burnet* would be pure dictum if it were applied to an issue of loss under Sec. *214(5)*.

The *instant* case involves solely an issue of *loss* under Sec. 23(e), Revenue Act of 1932, which corresponds to Sec. 214(5), the loss section of the 1926 Act.

(2) The issue in *Eckert v. Burnet* when it was tried before the Board of Tax Appeals was whether or not, as a *matter of law*, what the parties did *constituted* payment of the Corporation's note. The Board held that it did not constitute payment because the taxpayer Eckert "merely exchanged his note * * * for the Corporation's notes without any outlay of cash or property having a cash value." There was merely an extension of the old obligation with no agreement between the parties that what was done should constitute payment. The stamping of the note by the Bank as "PAID" did not of course prove payment by Eckert. It is common practice in most banks to stamp renewed notes as "PAID."

That is not the issue in the present case, where *payment* has been found as a fact.

POINT 3.

But even if Eckert v. Burnet is to be considered as correctly stating the rule as to the deduction of losses, the taxpayer here complied with that rule in all respects, and is entitled to deduct his loss.

(1) The rule as stated in *Eckert v. Burnet* establishes *Payment* as the test of deductibility. The language of *Eckert v. Burnet* makes it perfectly clear that Eckert would be entitled to deduct the bad debt "if the petitioner ultimately *pays* his note." (Emphasis supplied.) (283 U. S., p. 142.)

(2) The rule that *payment* by the taxpayer of the obligation in question is the best test of its deductibility has been followed in numerous cases:

United States v. Collier, (C. C. A. 5), 104 F. (2d) 420.
Bailey v. Commissioner, (5th Cir.) 103 F. (2d) 448.
Mellinger v. United States, (Ct. Cl.), 21 F. Supp. 964.
Humphrey v. Commissioner, 91 F. (2d) 155.
Schlemmer v. United States, 94 F. (2d) 77.
Insurance Finance Co. v. Commissioner, 84 F. (2d) 382.
Landers Bros. v. Commissioner, 60 F. (2d) 85.
Shiman v. Commissioner, 60 F. (2d) 65.
Jarvis v. Heiner, 39 F. (2d) 361.
A. D. Weiss, 13 B. T. A. 1284.

(3) Payment has been recognized as the best test of deductibility by the outstanding tax authorities.

In *Paul & Mertens "Law of Federal Income Taxation,"* the latest and outstanding work on the subject, we find the following:

"* * * the term 'cash method' is a misnomer. It does not mean that only cash receipts are taxable, any more than it means that all cash receipts are taxable. The thought is rather that *both taxable income and items of expenditure need not be in the form of cash.*" (Sec. 10.01.) Citing *46 Harvard Law Review* 933.

"Many of the decisions turn on the question of *security;* they regard as the equivalent of cash obligations which are in some way—by lien, mortgage or otherwise—*secured.* Often this question is valid because relevant to the point of *convertibility into cash.* * * * The real question is whether *cash can be realized;* has the equivalent of cash been received." (Sec. 10.05.) Citing *Bedell v. Commissioner*, 30 F. (2d) 622; *S. L. Meyer*, 23 B. T. A. 1200.

"Bonds, notes and contracts for the payment of money and other property are the equivalent of cash if received on an income producing transaction to the extent of their fair market value * * *." (Sec. 1016.) Citing *Brinkerhoff-Faris Trust Co.*, 14 B. T. A. 801.

"This whole subject of the extent to which notes should be treated as the equivalent of cash is still in a state of uncertainty. The general rule is clear that notes may be treated as the equivalent of cash; * * *." (Sec. 10.16.) Citing *Pinellas Ice & Cold Storage Co. v. Commissioner*, 287 U. S. 462. (Emphasis supplied.)

In *Holmes "Federal Taxes,"* sec. 471, the principle is stated as follows:

"It is not necessary that an amount claimed as a deduction be paid out in cash. Just as income may be received in kind or in the equivalent of cash, so *deductions may be represented by payments in some form other than cash*." (Emphasis supplied.)

Roswell Magill, former Undersecretary of the Treasury, in an article in the *Harvard Law Review*, Vol. 46, p. 936, states the principle as follows:

"A concession is necessary at the outset because the bulk of claims are not actually liquidated in cash; salaries, dividends, rent, interest, etc., are commonly paid by check. * * * *Negotiable notes have been treated as cash to the extent of their fair market value*, but a non-negotiable note has been regarded as giving rise to income only as collected." Citing *Lyle v. Olson*, 24 B. T. A. 702; *A. W. Wolfson*, 1 B. T. A. 538; *Potter Farms, Inc.*, 6 B. T. A. 110; *C. W. Slater*, 5 B. T. A. 804; *Mainard E. Crosby*, 14 B. T. A. 980. (Emphasis supplied.)

(4) The Commissioner's own regulations have for *twenty years* recognized this principle. Ever since the promulgation of Regulations 45 under the Revenue Act of 1918 and continuing through the successive regulations promulgated under the revenue acts ever since, the Commissioner has ruled as follows:

"Items of *income* and of *expenditure* which as gross income and *deductions* are elements in the computation of net income, *need not be in the form of cash*. It is sufficient that such items, if otherwise properly included in computation, *can be valued in terms of money*." (Art. 321 *Regs.* 77.) (Emphasis supplied.)

That rule has been recognized by the Bureau in several rulings and indeed insisted upon by the Bureau in numerous cases.

A. R. R. 113, C. B. 2, p. 114.
O. D. 741, C. B. 3, p. 115.
A. R. R. 479, C. B. 5, 146.
I. T. 1182, C. B. I-1, p. 142.
I. T. 1167, C. B. I-1, p. 149.
I. T. 1697, C. B. II-1, p. 95.

In *A. R. R. 479, supra*, the Bureau very clearly indicated that if a pre-existing obligation is *actually paid* by the acceptance of notes in extinguishment of the old obligation, such a payment would be an allowable deduction. The loss was disallowed there expressly because the taxpayer "simply renewed the old notes" and because "it appears clear that A has never become *primarily* liable for payment of the principal of said notes."

In the following cases the Bureau insisted upon the rule that payment is the test of deductibility:

Crain v. Commissioner, 75 F. (2d) 962.
Darling v. Commissioner, 49 F. (2d) 111.
Avery v. Commissioner, 22 F. (2d) 6.
Yoder v. Nauts, 34 F. (2d) 450.

(5) *Payment* of taxpayer's obligations upon his guaranty to the Bank was not only *found as a fact* by the Board of Tax Appeals, but was also conceded by the Commissioner and stipulated as a fact. (Dep. Clark, p. 73.)

Hence the issue of whether the guaranty was *paid* or not, is not an issue in the case. *Payment* was found as a

fact. Hence it could never have been an *issue of law* in this case.

The Board of Tax Appeals admitted all this in its opinion. The Commissioner conceded *before this Court* in his petition for certiorari that Mr. Price's note and securities were *accepted* by the North Carolina Bank and Trust Company "*in* final *settlement*" of Price's prior obligations upon his guaranty of the assets of the Atlantic Bank, and that: "Both the taxpayer and the Bank considered this to be a *final payment* of the two notes given under the guaranty." (Emphasis supplied) (Pet. for Cert. p. 6) (R. 15.)

* * * * *

(6) But, argues the Commissioner, Mr. Price's payment was not made *in cash*—therefore his loss is not deductible.

(a) The Commissioner's contention stultifies and nullifies his own regulations which have held for twenty years that such payments "need not be in the form of cash", but may be in the form of any property which "can be valued in terms of money". Art. 321, *Regulations 77* and *74;* Art. 22, *Regulations 69, 64, 62* and *45.*

This Regulation, Art. 321, *supra,* was issued under the general provisions as to the method of reporting income and deductions by *all* taxpayers, and necessarily applies to taxpayers on the cash basis of accounting.

In addition to this, however, the Commissioner's contention is squarely in conflict with the Commissioner's regulations as to the general doctrine of deductions of losses

which is found in Art. 23 (e) (1), *Regulations 86*, where it is said:

> "In general losses for which an amount may be deducted from gross income must be evidenced by *closed and completed transactions*, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed." (Emphasis supplied.)

The Board has found as a fact that in March, 1932, both the taxpayer's and Gold's obligations under the guaranty contract were *paid and discharged* by the acceptance by the North Carolina Bank & Trust Company of taxpayer's note for $250,000 and the securities assigned therewith, and that there was *no hope of recoupment* from the Class B assets. As the Board said: "Both petitioner and the Bank considered this to be a *final payment* of the two notes given under the guaranty." (Emphasis supplied.)

In other words, when the taxpayer paid his own and Mr. Gold's obligations under the guaranty and taxpayer's right of recoupment from the Class B assets became worthless in 1932, the whole guaranty transaction was definitely and finally ended. The Board finds this as a fact, and the Commissioner virtually admitted as much before the Board.

Did that constitute a closed and completed transaction? If so, then the taxpayer is entitled to deduct the loss since it would come squarely within the Commissioner's own regulations. The cases are practically uniform that *payment* of a pre-existing obligation such as a guaranty or contingent liability effectually and finally *discharges* that obligation, and any rights arising thereafter spring from a new undertaking and not from the old undertaking. This

has been recognized in the law of income taxation from the very earliest cases, as well as at general law. The question has always been—was the old undertaking *paid and discharged?*

In short, the legal purpose and effect of the *Payment* of a pre-existing obligation for tax purposes is to establish the fact that the *old obligation* has become a *closed and completed transaction;* and under the express provisions of the Commissioner's own regulations, in Art. 23 (e) above, the loss arising out of that transaction is a deductible one.

* * * * *

(b) The Commissioner's contention that the payment of a loss has to be made in cash, is in conflict with numerous tax cases decided by the Federal courts and the Board of Tax Appeals. These courts have considered the question from the economic as well as the legal aspects of the matter and have refused to be bound by the narrow concept that the payment of an obligation must be made in cash.

One of the best statements of that principle is found in *Schlemmer v. United States,* 94 F. (2d) 77, where the Second Circuit, speaking through Judge Learned Hand, said:

> "The plaintiff's note did not pay the company's debt, *unless the parties agreed that it should.* Peter v. Beverly, 10 Pet. 532, 568, 9 L. Ed. 522; Lyman v. Bank of United States, 12 How. 225, 243, 13 L. Ed. 965; The Emily Souder, 17 Wall. 666, 670, 21 L. Ed. 683; Segrist v. Crabtree, 131 U. S. 287, 9 S. Ct. 687, 33 L. Ed. 125. The defendant asserts that they had so agreed because of the tax returns; but that is not so.

Those did indeed presuppose that the note was a proper entry in a cash return, but that does not show that the parties had agreed that it should be payment; they may have supposed that a note so taken always pays the debt; or that it must be treated as cash whether it was payment or not. They were laymen, and we can tell nothing about what facts they took for true in reaching the conclusion that the note was cash. The only actual testimony was that the note was *not taken as payment*, but only as more permanent evidence of the debt. Indeed, it is not at all clear that it would have been a cash item, even if it had in fact been taken as payment. It did not change the substance of the debt—*not being endorsed or secured*—and although it was more readily disposable, *that single incident was scarcely enough.* There must be more than difference in the mere form of property to justify a charge of income. Weiss v. Stearn, 265 U. S. 242, 44 S. Ct. 490, 68 L. Ed. 1001, 33 A. L. R. 520. But we need not stand on that; in any case *since it was not taken as payment, it could not be treated as cash; the old debt remained, the note was no more than added security.*" Sass v. Commissioner, 12 B. T. A. 156 (semble); Merren v. Commissioner, 18 B. T. A. 156; Humphrey v. Commissioner, 32 B. T. A. 280. (Emphasis supplied.)

The Court of Claims has recognized the rule more than once. In *George J. Mellinger v. United States*, 21 F. Supp. 964, that Court said:

"If nothing had been done except to take new notes it would hardly be contended that there was a payment and that the new notes were evidence of income received. The rule in most jurisdictions, including the federal courts, is that *in the absence of agreement or*

consent to receive it as such, a promissory note of the debtor, although accepted by the creditor, does not in itself constitute payment or amount to a discharge of the debt. 48 C. J., p. 610, sec. 40. And the Board of Tax Appeals in *San Jacinto Life Ins. Co.*, 34 B. T. A. 186, held that a promissory note given in evidence of the liability of the maker for overdue interest upon which nothing was paid did not show that the taxpayer received any interest income. The evidence fails to show that there was *any agreement or understanding between the debtor and creditor that the new notes should operate as a payment and extinguish the original indebtedness.*" (Emphasis supplied.)

This principle has been recognized by the Federal courts as applied both to questions of income and questions of deductions from income. See *Humphrey v. Commissioner*, 91 F. (2d) 155 (9th Cir.); *Jenkins v. Smith*, 21 F. Supp. 433, affirmed 99 F. (2d) 827 (2nd Cir.); *Bedell v. Commissioner*, 30 F. (2d) 622 (2nd Cir.).

* * * * *

(c) The Commissioner's contention that the payment of a loss has to be made in cash, ignores the essence of the very rule laid down by this Court in *Eckert v. Burnet*—that losses are deductible whenever the taxpayer "makes an outlay of cash or *property having a cash value*". (Emphasis supplied.) (283 U. S., p. 141.)

It is interesting to note that this Court in stating the rule above, actually quoted the words of the Board of Tax Appeals, which has always adhered to the principle that a payment for purposes either of income or deduction need not be in cash. In fact the Board has held in many other cases

that the true test of the deduction is not necessarily the payment of cash, but is whether or not the payment in question represented a *closed and completed transaction.* See *Wilford C. Saeger*, 9 B. T. A. 890, 898; *Ewing Thomas Converting Co. v. McCaughan*, 43 F. (2d) 503; *Thatcher & Son*, 30 B. T. A. 510; *Consolidated Tea Co. v. Bowers*, 19 F. (2d) 382.

* * * * *

(d) The Commissioner's contention that the payment of a loss has to be made in cash is in conflict with the decisions of this Court and the courts of the several States, which hold that for any purpose, legal or equitable, payment of an obligation can be made in any form of property which the parties agree upon. These decisions hold without exception that a pre-existing obligation can be paid by the giving of cash, notes, checks, property or anything of value which is accepted by the creditor as payment; and that such payment discharges the prior obligation and deprives the creditor of any further action or remedy thereon.

This Court as early as *Segrist v. Crabtree*, 131 U. S. 287, 33 L. ed. 125, said:

> "One of the principal questions arising upon the evidence was whether two notes, payable respectively in September, 1881, and September, 1882, were received in *actual payment* (in which event the *remedy is upon the notes*), or only as evidence of the amount to be paid by Crabtree. In *Sheehy v. Mandeville*, 10 U. S. 6 Cranch, 253, 264 (3:215, 219, *Chief Justice* Marshall said: 'That a note, *without a special contract*, would not, of itself, discharge the original cause of action, is not denied. But it is insisted that if, by express agreement, the note *is received as payment*, it satisfies the original contract, and the party receiving it must take

his remedy on it. *This principle appears to be well settled.* * * * Since, then, the plaintiff has not taken issue on the averment that the note was given and received in discharge of the account, but has demurred to the plea, that fact is admitted, and, being admitted it *bars the action for the goods!*" (Emphasis supplied.)

The Supreme Court of Iowa in the recent case of *State v. Chambers*, 179 Iowa 436, 161 N. W. 470, states the rule as follows:

"When the parties agree to treat something other than money as constituting payment, the law will so treat it."

In *Roberts v. Vonnegut*, 58 Ind. App. 142, 104 N. E. 321, the highest court of Indiana said:

"Anything is payment which the one obligated offers as payment, and the one to whom payment is due accepts as payment."

The general rule prevalent throughout the State courts is stated in 21 *R. C. L., Payment*, Sec. 45, page 47, as follows:

"In the absence of statutory restrictions the parties to an agreement at the time of entering into or at any other time may waive payment in money, and the promisee may agree to accept in payment notes, checks, drafts, or any other thing of value. In other words, the parties to a contract may agree as to the medium of payment and their contract will be enforced." (Citing cases from all jurisdictions.)

And in the same article, Sec. 72, page 72, it is said:

"If there is an express agreement by the creditor to receive a note as absolute payment and to run the risk

of its being paid, it will be held to be an extinguishment or payment of the precedent debt, whether *the note is afterwards paid or not;* but a clear agreement or manifestation of intention of both the parties to that effect is essential." (Emphasis supplied.)

There seems to be no doubt whatever but that the giving of a note may constitute payment of an antecedent obligation of any sort. *Clarendon County v. Curtis,* 46 F. (2d) 888; *In Re Dixon,* 13 Fed. 109. Whether or not the giving of a note to cover an antecedent obligation constitutes payment and discharge thereof depends solely upon the intention of the parties, *i. e.*, whether the old obligation is merely renewed, or a new obligation differing in its terms is created. *Horne v. Young,* 40 Ga. 193; *Dewey v. Bell,* 5 Allen (Mass.) 165; *Squires v. Adams,* 70 Ill. App. 502.

In North Carolina where this taxpayer lives, the authorities are absolutely uniform that where a note is given merely in renewal of a prior note or obligation, the giving of the second note does not extinguish the original debt nor in any way change the debt, except to extend the time of payment—*but if the second note is given and accepted in payment of the old debt and not merely in renewal thereof, an entirely different principle applies and the old obligation is extinguished for all purposes.*

Smith v. Bynum, 92 N. C. 108.
Terry v. Robins, 128 N. C. 140.
Bank v. Hall, 174 N. C. 479.
Kilpatrick v. Kilpatrick, 187 N. C. 523.
Dyer v. Bray, 208 N. C. 248.

* * * * *

(e) The Commissioner's contention that the payment of a loss has to be made in cash fails to take into account

the *legal effect* of what took place. In reality the transaction constituted a payment of taxpayer's admitted loss with borrowed funds.

The Court below said this:

> "The facts of the case, in final analysis, amount to a borrowing by taxpayer from the Bank of funds with which to meet the liability on his guaranty and the application of the proceeds of the loan to that purpose; and we know of no principle of law or of justice which would deny him the right to deduct the loss arising from his guaranty until that loan is repaid."

The facts of record fully support that conclusion of the Court below. The taxpayer, Mr. Price, from numerous conferences with the Bank, knew that the Bank needed the cash and that his note could be discounted immediately for cash by the Bank. The very fact that his note was as good as cash and could be immediately discounted for cash, was one of the reasons, of course, why the Bank was willing to accept Mr. Price's note and securities as payment of the guaranty.

The Federal courts have held in numerous tax cases and the Commissioner has conceded in those cases that, if the taxpayer had borrowed funds from another bank across the street on exactly the same note as the taxpayer gave the North Carolina Bank, undoubtedly he would have been entitled to deduct the loss in 1932. Such is the holding in *Crain, Executors, et al. v. Commissioner*, 75 F. (2d) 962, which decision the Commissioner published as having the effect of a Bureau Ruling in C. B. XIV-2, p. 281. To the same effect are *Jenkins, et al. v. Smith*, 21 F. Supp. 433; *Jarvis v. Heiner*, 39 F. (2d) 361; *Humphrey v. Commis-*

sioner, 91 F. (2d) 155; *Weis v. Commissioner*, 13 B. T. A. 1284.

The *Crain case, supra*, is important because the facts in that case, in the essential particulars, are similar to the facts in the case at bar. In that case the taxpayer took the same position that the Commissioner takes in the instant case. The Court held that the taxpayer was wrong and the Commissioner was right. In the *Crain case* it was conceded that taxpayer was on the *cash receipts and disbursements basis*. He with one Wesson was jointly liable on the assumed obligations of the debts of the National Car Advertising Co. It was evident in 1913 that there would be a loss for which they would ultimately be liable. The essential facts are best expressed by the Court in its opinion as follows:

> But in the year 1916, the amount of the *loss became definitely certain*, and the whole of it was actually paid by Wesson. Since the taxpayer did not himself have on hand enough cash to pay his half, he agreed with Wesson that the latter should *advance all of the money in payment of the loss*, and the *taxpayer would make to Wesson a note for the taxpayer's half of such loss.*
>
> "*In fair effect, what the taxpayer did in 1916 was to borrow $40,000* in money with which to pay the loss, now here in dispute, as to the date of its accrual for taxing purposes. It seems clear, from the facts here and the ruled cases, that the loss occurred in 1916. Avery *v.* Commissioner (C. C. A.), 22 F. (2d) 6, 55 A. L. R. 1277; Darling *v.* Commissioner (C. C. A.), 49 F. (2d) 111. Did the giving of the note to Wesson have the effect to lawfully postpone deduction of the loss from income till the year in which the note was paid?

"The taxpayer contends that it did, and, so contending, relies largely on the case of Eckert *v.* Commissioner, 283 U. S. 140, 51 S. Ct. 373, 374, 75 L. Ed. 911, as decisive in his favor. * * * " (Emphasis supplied.)

The Court in this opinion distinguishes the *Crain case* from the *Eckert case* and holds that the deductible loss occurred in 1916. The Court then says:

"Moreover, counsel agree, and the decisions of the Board of Tax Appeals sustain their agreement, that the fact that *a loss is paid in borrowed money does not have the effect to change the date at which the loss was sustained from the year of the loss to the year in which the borrowed money was repaid.*

* * * * *

"To the same effect are the cases of Weis *v.* Commissioner, 13 B. T. A. 1284; Crawford *v.* Commissioner, 11 B. T. A. 1299; and Perry *v.* Commissioner, 28 B. T. A. 497." (Emphasis supplied.)

In fair effect, as decided by the Court below, what Mr. Price did was to borrow funds from the North Carolina Bank and Trust Company to pay to it his loss under the guaranty, which was first definitely ascertained in March, 1932, to be $250,000. Paying the loss under the guaranty as he did, by giving his fully secured note to the North Carolina Bank & Trust Company, left him in reality in exactly the same situation as if he had made the fully secured note in question to another bank and had used the proceeds to pay his loss under the guaranty to the North Carolina Bank & Trust Company. The Government concedes if Mr. Price had given said note to another bank and used the proceeds to pay the loss under the guaranty, he would have had a loss for tax purposes and would be entitled to the de-

duction claimed. The reality of the situation is that the loss of the taxpayer is just as genuine and the payment to the bank of the loss under the guaranty just as complete, as if Mr. Price had borrowed from another bank. The fact that the borrowing was from the same bank to which the loss under the guaranty was paid, can make no real difference. It is utterly immaterial where the taxpayer borrowed the funds if the result thereof resulted, as in this case, in the payment of his admitted loss. That there was payment by the taxpayer of his loss is not open to question, since the Board of Tax Appeals has found as a fact that the taxpayer did make payment.

As recently stated by this Court in *Helvering v. Lazarus* (December 4, 1939): "In the field of taxation administrators of the laws and the courts are concerned with substance and realities." Just so, the form of the transaction in the instant case is unimportant since what really happened was a payment by the taxpayer of his loss under the guaranty with funds which happened to be borrowed from the same bank upon the taxpayer's fully secured note. The point is that Mr. Price was not renewing a note; he was paying an established loss under a guaranty, in effect, with funds borrowed on his own secured note.

The case of *Jenkins et al. v. Smith*, 21 F. Supp. 433, affirmed 99 F. (2d) 827, is closely analogous on the facts to the instant case. In that case the taxpayer, in order to protect his investment in the stock of a bank in which he was a director, made a guaranty agreement together with other directors, and deposited certain collateral. In the following year, 1933, the bank ceased doing business and called upon the guarantors for payment under their guaranty. The taxpayer thereupon arranged to borrow *from the same bank*

the same amount of money for which he was liable, giving to the bank his own promissory note. In that way the taxpayer claimed a loss in his return for 1933. Said the Court:

"The deduction was proper and plaintiffs must prevail if, under all the circumstances, *the obligation on the bond was paid.* The defendant urges, however, that there was no payment in fact, but only in form, since the decedent remained obligated to the First National Bank and Trust Company for the same amount, evidenced by a new note. He parted with no cash in 1933, but merely borrowed from his payee in order to pay the same payee.

"In my opinion, *the obligation on the bond* was discharged by the acceptance by the First National of the check as payment. *Where or how the decedent obtained the money with which to make the check good is immaterial.* The acceptance of the check as payment discharged the obligation even though it created an overdraft. A new cause of action arose upon the check. The First National could no longer have sued the decedent on the bond. The bank knew of the overdraft, but was satisfied to take its chances on the new obligation. *The bond transaction was closed.*

"The credit to the decedent's account, made on the same day, was the result of a new transaction, initiated by a promissory note to the bank secured by new collateral. It was in no sense an extension of time for payment of the old debt. It was *a new contract of a substantially different nature.*" (Emphasis supplied.)

One of the best statements of the principle is found in *A. D. Weis*, 13 B. T. A. 1284. In that case taxpayer entered with one Morgan into a business venture, the capital for which was furnished by the taxpayer. Part of such capital

was out of taxpayer's own funds and part was money borrowed by him from a bank. The business was unincorporated. It was understood between taxpayer and Morgan that taxpayer would be responsible for the finances of the venture. The venture borrowed money from the bank during the first part of 1919 in the amount of $9,000, and notes were executed in the name of the venture. The venture proved a failure in the latter part of the same year. Morgan was without resources. The bank pressed for payment of the note executed by the venture, and taxpayer gave his own note to the bank in the amount of the principal plus accrued interest. This note was not paid by the taxpayer until 1923. The taxpayer claimed a deduction, however, as a loss for 1919. The Board sustained the taxpayer's claim and said:

> "We are of the opinion that all the losses here in question were sustained in the years in which the several investments became worthless. In such respective years each of the deals became a closed transaction and the petitioner's net assets were reduced in the amount of the loss sustained. *It is not material whether such losses were met by the payment of cash from funds in hand or with cash borrowed from the bank and evidenced by notes payable in a subsequent year.* The loss had been sustained and the transaction had been closed by a cash payment. *The use of the petitioner's credit to secure funds from the bank was a new and different deal and had no more to do with the petitioner's tax liability than any other borrowing that he did in the taxable year.* Cf. *Bob H. McGinnis*, 4 B. T. A. 209." (Emphasis supplied.)

In the case of *John C. Hermann*, 27 B. T. A. 409, the same rule is followed. In that case taxpayer borrowed a

sum of money from an insurance company in 1919. In 1928, the year in question, he was indebted to the insurance company for the original loan plus accrued interest, totalling $5,293. In that year he accordingly borrowed $8,725 from the insurance company, from which amount the company deducted the old loan and accrued interest, and paid to taxpayer the net difference. The taxpayer claimed the amount paid as a deduction in 1928. The Board sustained the taxpayer, saying:

> "We have consistently held that the borrowing of money with which to pay deductible business expenses does not postpone credit for the payment to the year of repayment of the loans. *Ida Wolff Schick*, 22 B. T. A. 1067; *Robert B. Kennan*, 20 B. T. A. 498. The fact that the full amount of the second loan was not handed to this petitioner in cash and the sum necessary to cover the first loan and interest handed back is of no importance. It was applied in satisfaction of petitioner's indebtedness and so was constructively received and disbursed by him. *United States v. Boston & Maine R. R. Co.*, 279 U. S. 732; *Henry D. Muller*, 16 B. T. A. 1015; *Mrs. Frank Andrews*, 26 B. T. A. 642."

While certain portions of the *Hermann* opinion have been modified in a later decision of the Board in *S. E. Thomason*, 33 B. T. A. 576, that part of the opinion quoted above has not been modified and remains a correct statement of the law.

In the case of *Keenan v. Commissioner*, 20 B. T. A. 498, the Board adhered to the same principle and said:

> "That the payments were made with borrowed money is not material and can not have the effect of

postponing the deductions until the years in which the borrowed money was repaid. To hold otherwise would in effect permit taxpayers to elect the years in which expenses might be deducted from income."

Under the theory of the Board's decision in this case Mr. Price, the taxpayer, was not entitled to deduct the loss in 1932, and can not deduct the loss until he pays the $250,000 note which he executed in 1932. Under that theory Mr. Price could wait until 1940 or even later if he chooses, and take a deduction for a loss which all the facts show was actually fixed and determined and was economically suffered by the taxpayer in 1932.

Or, if Mr. Price is unable to pay the note at one time, perhaps he may pay a part of it in 1939, a part of it in 1940, and the balance in 1941. If the Board's theory is correct then Mr. Price should be entitled to deduct as a loss in each of those years the amount which he actually pays in each of those years and thus he could spread over three years a deduction which actually occurred ten years previous. That is the logic and the inevitable result if the Board's theory is correct.

The Federal courts, however, have already expressed themselves upon this point in other cases. See *Darling v. Commissioner*, 49 F. (2d) 111; *Avery v. Commissioner*, 22 F. (2d) 6; and *Humphrey v. Commissioner*, 91 F. (2d) 161.

In the very recent case of *United States v. Collier*, 104 F. (2d) 420, the Circuit Court of Appeals, Fifth Circuit, had before it several transactions involving deductions on account of interest and discounts which the taxpayer had constructively paid with borrowed funds. In holding that

payments thus constructively made were deductible, the Court said:

> "We think the judge could conclude that the transaction of loan with the bank was really Collier's throughout, done through the Collier Service Corporation in order to obtain its indorsement and credit with its bank, *and that he was to bear the discount, and did pay it when he entered credit for it on the account he had against the corporation.* We will not overrule this fact conclusion." (Emphasis supplied.)

The Court below recognized the realities of the taxpayer's situation, and held that in fair effect the transaction amounted to a borrowing of credit from the Bank with which to meet taxpayer's admitted liability under the guaranty. Then said the Court:

> "It will not do to say that taxpayer sustained the loss when he paid the debt and not when he incurred it for the purpose of meeting the loss; for one does not sustain a loss by merely paying a debt for which he himself is primarily liable, nor is the loss deferred by contracting a debt with which to pay it. The able attorney representing the Commissioner very properly admitted on the argument that, if taxpayer had obtained the $250,000 to meet the loss *by giving the note to another bank*, he would have been entitled to the deduction claimed; but surely his right to the deduction cannot depend upon the *identity of the bank which extends credit to him.*
>
> * * * * * *
>
> "It is argued that the fact that taxpayer is on the cash receipts and disbursements basis intead of the accrual basis make a difference; but we do not think

so. The question is not one of accruing a loss to occur in the future, but of *dealing with a loss that has already occurred;* and, as heretofore stated, the occurrence of the loss cannot be said to be postponed merely because credit is obtained with which to meet it." (Emphasis supplied.)

* * * * *

(f) The Commissioner's contention that the payment of a loss has to be made in cash, ignores the realities of the situation. In reality the final settlement agreed upon between the taxpayer and the Bank in March, 1932, was a *compromise of taxpayer's liability* under the guaranty. The taxpayer agreed to pay his and Gold's obligations to the Bank "provided they would extend to me certain accommodations", to quote the taxpayer's exact words. These were that the Bank would release him of all further liability under the guaranty, would turn over to him Gold's note for what it was worth, and would not press for payment of the new note. These were all valuable considerations to the taxpayer, especially in 1932 when values were shifting so rapidly and time was of the essence.

It is clear, therefore, that the taxpayer's note for $250,000 executed in 1932 was a new undertaking upon entirely different terms and conditions from either his or Gold's obligations under the guaranty. Mr. Price then assumed an enfirely different obligation from what had previously existed. His liability, previously contingent and uncertain, was now fixed and certain and limited to a definite amount. Taxpayer surrendered certain rights under the guaranty, but he acquired certain rights or claims of the Bank against the Gold estate. In short, there was ample

consideration on both sides for the compromise settlement which took place in 1932.

In other words, in 1932 taxpayer entered into an entirely separate and different relationship with the Bank. At the time he paid his liability in 1932 he ceased to be a guarantor of the Bank and became a debtor of the Bank. When the taxpayer ascertained in 1932 what the losses were in the A assets and that the B assets were likewise worthless, for the first time the relationship of debtor and creditor arose between them. Taxpayer thereupon paid the Bank with the only property he had available, and it was then that his economic loss occurred.

To say that a taxpayer sustains no real or economic loss under a guaranty contract when all the events have occurred which fix his liability and determine its exact amount; when his only source of reimbursement (the Class B assets) has become worthless and the taxpayer has delivered his note to the creditor and has assigned property in excess of his admitted liability—is simply to ignore all the canons of sound business practice and common sense. *Taxpayer has then admitted his liability and he has parted with property worth in excess of the liability.* True, he still has a right to redeem that property some time in the future if he can. But in order to do so he will have to part with other property of equal value, *i. e.*, make a substitution of something else for the securities held by the Bank. *But that substitution, years later perhaps, is not the thing that causes his loss.*

This is best shown by a simple illustration. Suppose Mr. Price had simply delivered to the Bank United States bonds worth $250,000 and the Bank had accepted them in final

payment of his obligation under the guaranty. No one could contend for a moment that the taxpayer had not sustained a deductible loss. Let us go one step further. Suppose Mr. Price had delivered to the Bank United States bonds worth $250,000 and the Bank had accepted them in final payment of his obligation under the guaranty, with a collateral agreement that Mr. Price could repurchase them for cash at any time within two years. Would anyone contend for a moment that Mr. Price had not sustained a deductible loss? We think not. See 48 C J. Payment Sec. 41; Jenkins v. Smith, 21 F. S. 433; Smith v. Young, 11 Bush (Ky.) 393.

But is that not in reality exactly what happened? Mr. Price assigned to the Bank securities worth $250,000 with the understanding that he could reacquire them, or in effect repurchase them, within two years by giving the Bank their equivalent in money. What is the difference in legal effect?

The equity of the taxpayer's position is equally apparent. The Commissioner apparently loses sight of the fact that Mr. Price's financial condition was completely changed by making this payment in March, 1932. Prior to that date his obligations under the guaranty were purely contingent and his securities were delivered to the Bank merely to protect his guaranty. But in March, 1932, his liability was admitted, the amount was fixed and payment was demanded, and the taxpayer reassigned his securities to the Bank as part of the *terms and conditions of payment*. *Prior* to March, 1932, Price could have gotten his securities back without the payment of a dollar, if the Class B assets proved sufficient to protect his guaranty. But *after* March, 1932, Price could *never* get those securities back without giving up cash or other property of equal value.

In other words, in March 1932, Price for the first time parted irrevocably with property worth $250,000, and his estate was diminished accordingly. Such is the holding of the Court below (R. 37) and we submit that is the true test of an economic loss.

There is another equitable aspect of the case that merits consideration. The Commissioner in his regulations has always ruled and in the courts has contended that, whenever a taxpayer on the cash basis accepts a note in payment of a debt, which is the equivalent of cash—such note must be included in the taxpayer's gross income for that year. *Regulations 33*, Art. 4; *A. R. R.* 2895, C. B. II-2, p. 233; *I. T. 1262*, C. B. I-1, p. 71; *A. W. Wolfson*, 1 B. T. A. 538; *C. R. Johnson*, 8 B. T. A. 992; *Magill, 46 Harvard Law Review*, 933.

Under any fair and consistent system of taxation, where the payment of an obligation is held to constitute income to the creditor, the disbursement of that payment is ordinarily deemed to constitute a deduction from the income of the debtor. This Court has recognized the principle that items of income and of deduction under these circumstances are corollaries of each other and in general should be consistently treated. In *Burnet v. Logan*, 283 U. S. 404, this Court said:

> "*Ordinarily*, at least, a taxpayer may not deduct from gross receipts a supposed loss which in fact is represented by his outstanding note. *Eckert v. Commissioner of Internal Revenue*, 83 U. S. 140, *ante*, 911, 51 S. Ct. 373. *And, conversely*, a promise to pay indeterminate sums of money is not necessarily taxable income. (Emphasis supplied.)

The Circuit Court of Appeals, Second Circuit, in *Commissioner v. John Thatcher & Son*, 76 F. (2d) 900, makes it clear items of income and items of deduction under such circumstances are reciprocal and are corollaries of each other. In that case the same court had both sides of the same transaction before it. On the one side the taxpayer, a general contractor, claimed a *loss* under a building contract by reason of the default of certain sub-contractors; on the other side the government contended that the taxpayer's claim for reimbursement from the sub-contractors should be included as *income* to the taxpayer, thereby offsetting any loss. Said the Court:

> "We think the taxpayer's claim for damages against the subcontractors and their sureties was too contingent and uncertain to be treated as compensation by 'insurance or otherwise' for the loss. It is clear from the authorities that the subcontractors and their sureties sustained no deductible loss because of the taxpayer's assertion of a claim which they disputed. *Lucas v. American Code Co.*, 280 U. S. 445, 50 S. Ct. 202, 74 L. Ed. 538, 67 A. L. R. 1010; *Burnet v. Huff*, 288 U. S. 156, 53 S. Ct. 330, 77 L. Ed. 670. *If the liability of the obligor is too contingent to be accrued as a loss* to him, it would seem to follow that the claim of the obligee is likewise *too contingent to be considered compensation* for a loss already realized by the latter. See *Commissioner v. Highway Trailer Co.*, 72 F. (2d) 913 (C. C. A. 7); *Commissioner v. Southeastern Express Co.*, 56 F. (2d) 600 (C. C. A. 5)." (Emphasis supplied.)

The Circuit Court of Appeals, Fourth Circuit, has also expressed this principle that items of income and of deduction under these circumstances are in general to be treated on the same basis. In *Niagara Share Corp. v. Commis-*

sioner, 82 F. (2d) 208, the Court discussed the *Thatcher case*, *supra*, and said:

> "The facts in the case of *Commissioner v. John Thatcher & Son, supra*, are similar to the facts here, except that the taxpayer in the *Thatcher case* made no recovery under its indemnifying bonds and here the taxpayer made only a partial recovery. The principle that should govern both cases is the same and in the *Thatcher case* the court held that the taxpayer was entitled to the deduction and that had the taxpayer succeeded in recovering such recovery would have been income in the year when recovered. *Certainly if the guarantors in the contract involved here had sought to claim a loss under their contract as a deduction in their return for taxation* in any year prior to the year in which, at the end of litigation they were compelled to pay, it would not have been allowed as their liability was too contingent. *This being true, it must follow that any recovery that might be made by the petitioner was too contingent* to defeat the accrual of the loss to it in the year in which the loss occurred." (Emphasis supplied.)

The leading text writers on taxation agree that this is one of the principles which has been followed by our courts under our system of income taxation. In discussing the general principles governing items of income and deduction, *Paul & Mertens*, in sec. 10.01, state this principle as follows:

> "It is sufficient to subject an item to taxability if it is received in the equivalent of cash; by the same token an item of expenditure if otherwise deductible may be allowed as a deduction if paid in the equivalent of cash."

Similarly, under sec. 11.21, it is said:

> *"The corollary of the rule stated in regard to income is true with respect to deductions.* Taxpayers on a cash basis may not take advantage of a liability to pay; they have no right to a deduction until they make payment." (Emphasis supplied.)

The same rule is stated in *Holmes on Federal Taxes*, sec. 471, as follows:

> "It is not necessary that an amount claimed as a deduction be paid out in cash. Just as income may be received in kind or in the equivalent of cash, so *deductions may be represented by payments in some form other than cash.*" (Emphasis supplied.)

The equity of the matter is this. So long as the Commissioner contends and the courts hold that where a secured note having an equivalent cash value is accepted in payment of an obligation and thereby constitutes income to the creditor on the cash basis, conversely and reciprocally the courts should hold that the debtor who has thus parted with the equivalent of cash, is entitled to deduct the payment so made—under any equitable system of taxation.

The Court below has been completely consistent in its decisions on this question. In *Allen v. Commissioner*, (4th Cir.) ... F. (2d) ..., it was held that the receipt of shares of stock in payment for services to be rendered in the future, constituted income when received in 1934, and not in later years when the taxpayer rendered the services and disposed of said stock.

Similarly in *First National Bank, Executors, v. Commissioner*, (6th Cir.), ... F. (2d) ..., it was held that a note

received by the decedent in September 1929, under an agreement with another stockholder of a corporation to induce the decedent to agree to a transaction between that corporation and another corporation, was income to the decedent in 1929, although it was not payable until January 31, 1930.

Other Authorities Relied On By Commissioner.

The Commissioner cites other cases in his brief, but apparently does not rely upon any of them as controlling in this case. The only other cases upon which the Commissioner relies to any extent are *Jenkins v. Bitgood*, 101 F. (2d) 17, and *Ferris v. Commissioner*, 102 F. (2d) 985, a *per curiam* decision.

We have already pointed out in the taxpayer's brief in opposition to this Writ that both of those cases are factually different. A full discussion of those cases and the principles which distinguish them may be found in the taxpayer's brief in opposition to the Writ, pages 11 to 14, and we see no purpose in repeating that discussion here.

POINT 4.

The decision of the Court below has nothing whatever to do with obliterating the distinction between the cash basis and the accrual basis of accounting.

The Commissioner argued in his petition for certiorari that the decision here obliterates the distinction between the cash and accrual basis of accounting. That argument appears inferentially in the Commissioner's brief on certiorari, so we assume that the Commissioner is perhaps relying upon it.

That argument of the Commissioner, however, obviously has no merit. This case was decided by the Court below upon the peculiar and unusual facts which distinguish it from any other case counsel has been able to discover. The decision below is based squarely upon the agreement between Mr. Price and the North Carolina Bank & Trust Company by which Price's obligations (as well as Gold's) under the guaranty were finally compromised and paid. The Court called this the "crucial matter" of the case and quoted in full the finding of the Board of Tax Appeals on that point as the actual basis of its decision. (R. 34.)

The Court below did not evade the principle that Payment is essential to the deduction of a loss by a taxpayer on the cash basis. On the other hand, the Court affirmed that principle in express language (R. 40), and held that the taxpayer Price had met its requirements by actually paying the loss under the guaranty with borrowed funds. Said the Court below:

> "In other words, the taxpayer may not take deduction for a loss where what he has done is merely to postpone the evil day of reckoning. He may take the deduction where he has met the evil day and the loss has been realized. *The fact that he borrows money to meet it is immaterial;* the fact that he borrows to meet an outstanding obligation out of which the loss arises is immaterial; and the fact that he borrows from the person to whom the obligation is due is immaterial, provided that there is, as there was here, *a real payment of such obligation in money or money's worth and not a mere extension or renewal.*" (Emphasis supplied.)

More than that, however, the Commissioner has himself conceded that there was a *payment* by taxpayer of the loss under the guaranty (Brief, pp. 7, 12). Payment was found as a fact by the Board (R. 15). Since payment is the test of deductibility under the cash basis, and since the Court below rests its decision upon the fact that there was a Payment of the guaranty—how can it possibly be contended that the Court's decision "obliterates the distinction between the cash and accrual bases of accounting?". Instead of obliterating the distinction, the Court below actually affirms the distinction by basing its decision squarely on *payment*.

The Alternatives.

Apparently the Commissioner is determined to deny the deductibility of losses in such cases as this regardless of its effect upon the revenue. There are two ways of looking at such cases, and as usual the decision will cut both ways.

If the taxpayer is sustained in his contention, then such losses as this can be sustained in *one taxable year* only, and hence can not possibly be deducted except in that one year. But if the Commissioner's contention is upheld, then, as pointed out by the Court below, the way is open for "taxpayers to spread losses of this character over a number of years by the simple expedient of giving a note or notes in settlement of the loss and claiming a series of deductions as such notes are paid."

It is obviously the purpose of the Revenue Acts to require the reporting of income and to allow the deduction of losses in the taxable period in which those items *reflect* the taxpayer's *correct income*. It seems not only equitable, but also common sense to permit the deduction of a loss in the

period when "the deal became a closed transaction and the taxpayer's *net assets* were reduced in the amount of the loss", to quote the Board of Tax Appeals in *A. D. Weis*, *supra*. The Commissioner concedes that the loss has occurred (Brief p. 9) and that it occurred in 1932 (Brief p. 10), and is only concerned apparently with *when* to allow it (Brief p. 10).

The logical result and indeed the only possible result of the Commissioner's position as stated here is that such losses can be deducted in such cases as and when the notes of the taxpayer are finally paid in cash—years perhaps after the actual loss took place. It leads obviously to a situation where taxpayers can manipulate their taxes by spreading their losses over a period of years, by the simple expedient of giving a note or series of notes and paying them off from year to year, as may be required to offset their income.

Such a procedure certainly would not correctly reflect the taxpayer's financial condition, because his economic loss would occur years before it was reflected in his tax returns. We can not believe that such was the intent of Congress in providing that losses shall be deductible in the year in which they are sustained. See *Rhodes v. Commissioner*, 100 F. (2d) 966, 969.

Such a result was not contemplated by this Court in *Eckert v. Burnet*. As pointed out by Judge Hand in *Shiman v. Commissioner*, 60 F. (2d) 65;

> "We can see no ground therefore for question except some of the language used in Eckert v. Burnet, 283 U. S. 140, 51 S. Ct. 373, 75 L. Ed. 911, taken from our opinion in 42 F. (2d) 158. That was quite another situa-

tion. Eckert, the taxpayer, had been an accommodation endorser for a corporation which became insolvent. When called upon to *pay* he gave his note *instead*, not payable within the year. The court refused to allow the deduction, because Eckert was keeping his books on a cash basis, but it intimated that when he paid he might succeed; until then he had done no more than change the form of the obligation. Yet if it were enough to defeat him that the debt was 'worthless when acquired,' *the same objection ought to be good after he had paid; contrary to what was suggested. We cannot therefore think that the language so thrown out was intended as an authoritative statement by which we must be bound.*" (Emphasis supplied.)

There is another aspect to this matter. The Commissioner's position in this case would lead to equal uncertainty on the income side of similar transactions. In innumerable transactions of this sort the Commissioner has held that a secured note accepted by a creditor in payment of an obligation constitutes income to such creditor on the cash basis, upon the theory that the acceptance of such note in payment is the equivalent of cash and constitutes a closed and completed transaction. If the Commissioner's contention here is sustained upon the ground that Mr. Price's fully secured note was *not the equivalent* of a cash payment—then the only logical basis for holding that such a payment is income to the creditor would also be knocked out of the picture.

In short, it seems rather obvious that from the standpoint of the revenue the Commissioner's contention, if sustained, would open up a veritable Pandora's box of problems.

As we have already pointed out, the Court below based its decision squarely upon the peculiar facts in this case and upon the fair effect which those facts had upon the taxpayer's economic condition. We respectfully submit that the decision of the Court below is sound in fact and in law, and should be upheld.

Respectfully,

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SUPREME COURT OF THE UNITED STATES.

No. 559.—October Term, 1939.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Julian Price. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[March 25, 1940.]

Mr. Chief Justice Hughes delivered the opinion of the Court.

Respondent in his income tax return for 1932 claimed a deduction for a loss upon a contract of guaranty. The Board of Tax Appeals sustained the Commissioner in refusing to allow the deduction, and the Circuit Court of Appeals reversed. 106 F. (2d) 336. Because of an alleged conflict with *Eckert* v. *Burnet*, 283 U. S. 140, *Jenkins* v. *Bidgood*, C. C. A. 2d, 101 F. (2d) 17, and *Ferris* v. *Commissioner*, C. C. A. 2d, 102 F. (2d) 985, we granted certiorari. January 15, 1940.

The facts as found may be thus summarized: In 1929 the Atlantic Bank and Trust Company of Greensboro, North Carolina, was merged with the North Carolina Bank and Trust Company. The latter accepted conditionally certain assets of the Atlantic Bank called "A" assets, and certain other assets, called "B" assets, were pledged to that Bank with authority to charge against them any losses which might be established in realizing upon the "A" assets. Respondent and three other stockholders of the Atlantic Bank executed an agreement of guaranty, to the effect that if the North Carolina Bank failed to realize a certain sum from the "A" assets within two years they would make up the deficiency in an amount not exceeding $500,000. The agreement provided that any sum realized from the "B" assets were to be applied first to any losses occurring in the "A" assets and then to the reimbursement of the four guarantors. The period for realizing upon the "A" assets was extended until September, 1932.

In June, 1931, the North Carolina Bank advised the guarantors that the "B" assets were not in such shape that the Bank could

use them to the extent necessary for banking purposes and requested the guarantors to put their guaranty into a bankable form so that it could be used by the Bank to obtain credit. Respondent accordingly gave to the Bank his note for $125,000 and endorsed the note of C. W. Gold, another guarantor, for a like amount and assigned certain securities to the Bank as collateral for the payment of his guaranty. The Bank agreed that respondent's ultimate liability should not exceed $250,000. At the end of 1931, the guaranty agreement was still in effect. The "B" assets were still in the process of collection. No demand had been made upon respondent. While it was known that there would be some loss to the guarantors, it was not definitely known in 1931 what the loss would be, and the guarantors had reason to believe that there would be a substantial reimbursement from the "B" assets of any losses.

In the early part of 1932, financial conditions being worse, the Bank concluded that it would have to collect upon the guaranty and called upon respondent to make a final settlement of his obligations. Accordingly, in March, 1932, respondent made his note to the Bank for $250,000 and received back the two notes. The Board of Tax Appeals found that both respondent and the Bank considered this to be a final payment of the two notes which had been given under the guaranty. The Bank retained the same collateral for the $250,000 note that it had previously held, and, in December, 1932, respondent substituted therefor certain securities of his own.

Respondent claimed a loss in 1932 in the amount of $125,000, that is, for his one-half of the guaranty. He did not then claim a loss on the other one-half because he still had a claim against the estate of Gold (who had died in 1932) for reimbursement. For that one-half, representing Gold's part of the guaranty, respondent claimed a loss in 1933 and that deduction is not here involved.

Respondent kept his accounts upon a cash basis. The Board of Tax Appeals ruled that respondent was not entitled to the deduction of $125,000 in 1932, upon the ground that "he made no outlay of cash" in the purported payment; he had satisfied his liability as guarantor "by a shifting of the form of his liability". His loss would be deductible "in the year in which he pays the note".

Respondent insists initially that the transaction in 1932 was considered by the parties as constituting a payment of respondent's

liability under the guaranty, and that this payment is a fact found by the Board of Tax Appeals and is not open to review. But the findings of the Board disclose the entire transaction, and its legal effect in the application of Section 23(e) of the Revenue Act of 1932, as to the deduction of losses sustained during the taxable year, was reviewable by the Circuit Court of Appeals. Its decision on that point is reviewable here.

Both the Commissioner and the Board of Tax Appeals relied upon our decision in *Eckert* v. *Burnet*, *supra*. In that case, the taxpayer's return was on the cash basis, and the question was as to a claim of deduction for the year 1925. The taxpayer and his partner were joint endorsers of notes issued by a corporation they had formed. In 1925, in settlement of their liability for an ascertained amount, they made a joint note for the amount due to the bank that held the corporation's paper, "received the old notes, marked paid, and destroyed them". We affirmed the ruling that the deduction should not be allowed.

The court below considered that decision as definite authority only for the holding that a loss of the sort set forth was not deductible under the "bad debt" provision of the statute. That indeed was stated in the opinion as the taxpayer's claim. But the taxpayer had also presented here as an alternative ground the theory of a loss sustained during the taxable year, a ground which the Board of Tax Appeals had considered and held to be untenable. 17 B. T. A. 263, 265, 266. And the Government argued both questions. The Government did not contend that the taxpayer might not at some time be entitled to a deduction "either on account of a bad debt or for a business loss"; the "sole question in dispute was whether he was entitled to the deduction in 1925, the year in which his note was given, or in the later year in which the taxpayer's liability on the note is actually liquidated by payment".

The reasoning of this Court was broad enough to cover both aspects of the case. We said:

"For the purpose of a return upon a cash basis, there was no loss in 1925. As happily stated by the Board of Tax Appeals, the petitioner 'merely exchanged his note under which he was primarily liable for the corporation's notes under which he was secondarily liable, without any outlay of cash or property having a cash value'. A deduction may be permissible in the taxable year in which the petitioner pays cash. The petitioner says that it was

definitely ascertained in 1925 that the petitioner would sustain the losses in question. So it was, if the petitioner ultimately pays his note".

We think that this decision is controlling in the instant case. As the return was on the cash basis, there could be no deduction in the year 1932, unless the substitution of respondent's note in that year constituted a payment in cash or its equivalent. There was no cash payment and under the doctrine of the *Eckert* case the giving of the taxpayer's own note was not the equivalent of cash to entitle the taxpayer to the deduction.

Respondent urges that his note was secured, but the collateral was not payment. It was given to secure respondent's promise to pay, and if that promise to pay was not sufficient to warrant the deduction until the promise was made good by actual payment, the giving of security for performance did not transform the promise into the payment required to constitute a deductible loss in the taxable year. See *Jenkins* v. *Bitgood*, 101 F. (2d) 17, 19.

The judgment of the Circuit Court of Appeals is reversed and the decision of the Board of Tax Appeals is affirmed.

It is so ordered.

Mr. Justice McReynolds took no part in the decision of this case.

A true copy.

Test:

Clerk, Supreme Court, U. S.